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Milko Štimac

BARONS UPRISING

A transition is a set of processes which eventually result in the total change of all segments of a society. It develops in two directions: as a political and an economic transition. The two must advance simultaneously and at similar pace; progress in one direction is not sustainable unless accompanied by progress in the other.

The aspired change is comprehensive by definition, since the transition is a process of passing from one form of organization of society to another, whereby all actors of that society change as well. Is it possible for the change of actors to occur spontaneously? Hardly. Each segment of society will resist change as long as the entire environment has changed up to the point where its very survival is compromised unless it accepts to change. Those who declared reforms their direct objective and receive a mandate from the voting majority to implement these reforms are supposed to pursue changes and create a better environment.

Hence it is futile to expect one segment of society (for example, representatives of big business and high finance) to be capable of changing on its own. Quite the opposite, what is more likely is desperate defense of the environment which enabled them to make big business and generate high finance – why change something that is a proven recipe for (personal) success and benefits?

From “the Mighty” to “the Weak”¹

What are the circumstances for acquiring high finance? The transition in our country has to be deeper than the transition in the rest of Eastern Europe. It does not start from socialism only, but from the final, i.e. degenerative developmental stage of something that used to be referred to as socialism, but was actually a regime that evolved from the rule of a party oligarchy into the rule of one family. The actual prerogatives of that family *de facto* made it an uncontested master of both politics and the economy.

What developed then was the organization of the state typical for every dictatorship: a corporate state. The erection of such a state was to a great extent fostered by war. The type of society established in such a state is similar to feudal society². As in every other feudal society, basic political and economic

¹ Stefan Uros IV Dusan Silni (“the Mighty”) (1308-1355), Serbian king and tsar, under whose rule Serbia reached its territorial zenith, becoming one of the largest states in Europe; Stefan Uros V Nejaki (“the Weak”) (1336-1371), Serbian ruler, Dusan Silni’s son, who was incompetent in sustaining the great empire created by his father.

² The comparison of socialism (although it would be much better to say a corporate state of quasi-socialist type) and feudalism is not new. Leszek Kolakowski was the first to describe socialism as “industrial feudalism”, drawing comprehensive parallels between their manifested forms, for example: the absence of vertical mobility in society, clear distinctions and relative independence of domains in politics and the economy, etc.

courses directly depend on the supreme ruler. He is the one to decide who is to do what and who is to manage what. He is the one who directly grants feudal estates to those whom he considers meritorious, thus creating aristocracy.

Similarly to feudal kingdoms, in our country we had a war and a looting aristocracy³. After the October 2000 changes, the former was first to suffer loss in a political sense, due to pressure from the international community. This could not be said for the latter. It continued to operate under new authorities, only the supreme ruler was changed. What is more, the supreme ruler rapidly evolved from a collective to an individual during the past three years.

Following the feudal analogy, a turning point in the pre-development of the transition in our country could be characterized, without exceptions, as barons uprising against the ruler. We are not very likely to find out whether this concerns the uprising of the war aristocracy trying to resume its position in politics, or the looting aristocracy trying to defend its economic interests from politics.

A step from “the Mighty” to “the Weak” turned out to be small, unlike the price paid for such discovery. The insignificance of that step shows up constantly, almost on a daily basis, from institution to institution, as they self-destruct from sheer emptiness and impotence. The smaller the step, the bigger the price – from the life of the Prime Minister of one country to its economic life. What remains are political, and above of all, economic activity, which are under the barons’ control is. The corporate state has confirmed its presence once again, threatening to compromise the modest transition that has been begun thus far.

Profit and Development

How likely is it that aristocrats without the ruler will transform into tax-paying capitalists? Into those who understand that the function of profit and the function of development must go in the same direction, with both profit and development being compromised otherwise? The answer is, of course, negative, as long as the political and economic environments remain as they are today – without institutions, without competition, without reforms.

There are attempts to defend the *status quo* by using another analogy, but they simply cannot be applied here. Namely, examples of big entrepreneurs and bankers from Western Europe and the United States, who acquired their initial capital in a manner that in no way can be described as “gentle”, which does not prevent them from playing a vital role in future economic development. This is a shallow remark, which probably deliberately does not take into account the basic difference between first days of capitalism in the West and what is happening in our country.

Capitalism in the West developed out of the fight against feudalism mainly through uprisings against rulers and the aristocracy. And for this reason the spirit

³ For details about the looting nature of something that is in our country incorrectly referred to as “primitive accumulation of capital” and its mechanisms, we recommend *Mladjan Dinkic “Economy of Destruction”*. The relation of “entrepreneurs” and the state administration toward the national economy and society in general continued to exist throughout the 1990s, including the period after hyperinflation.

of a capitalist is enterprising and active, developed out of the fight against the privileged. That spirit shows up both in conquering new spaces and markets⁴, and in establishing common institutions which serve everybody's needs, and not only those of the ruler and the aristocracy.

Our tycoons were created from their direct relation with the privileged. They are not familiar with institutions – they themselves are institutions in their own domain, their monopoly. The transition as a process is far from a bourgeois revolution in its methods, but in terms of goals, they are the same. The method that should be enforced in the transition today is the change of environment, including institutional capacity building, and immediate decentralization and liberalization of all processes, both political and economic. This is the only way to put social wealth, which is currently under the control of tycoons, in the service of development of the national economy. Without pressure of competition on one side and tax administration on the other, the situation will not change, while our economy continues to suffer the flight of capital at the national level⁵.

The Court Intelligentsia

Why then is this not happening to us? Of course, tycoons do not rule directly. More precisely, they rule directly in their domains, the domains that take the form of a monopolistic position in a specific economic activity. At the level of the state as a whole, i.e. as a totality of political and economic activity, they rule through a segment of society that is similar to a feudal court camarilla. What is more, the court camarilla is to a great extent a factor which facilitates the sustaining of continuity with the governance of the previous regime.

This opinion does not refer to the state apparatus itself, which has all the reasons to resist the change of environment. The social segment we are talking about exists at the top or near the top of that administration pyramid. Some senior experts involved in the administration permit their expertise to be abused by giving legitimacy to wrong and damaging policies. They also permit their expertise to be directly placed in the service of disintegration of the economic and political being of the nation, submitting it to the tycoons' interests.

Here we can also draw a parallel with independent experts in the West. As the ideologue of capitalism, the Western intelligentsia from the beginning of the modern era assumed a position against state authorities from that period. And such a critical position has been maintained for the most part until today.

Quite the opposite, circumstances in Central and Eastern Europe defined the intelligentsia as predominantly courtly, as part of a camarilla⁶. This social segment in our country today has assumed an almost grotesque form, as

⁴ The enterprising and free spirit of capitalism was best described by Hayek in "Road to Serfdom", in his discussion of the role of traveling merchants ("les pieds poudres")

⁵ Such a negative model functioned and is still present in many Latin American countries. One of its features is permanent susceptibility to crises and permanent pauperization of entire nations.

⁶ An example of the exception to this "historical rule" would be the intelligentsia of Poland in Balcerowicz's government. However, there the political elite open-heartedly accepted reforms and began the dismantlement of the quasi-socialistic cooperative state.

“independent” experts, whereby independence does not refer to the independence of spirit, but to readiness to equally represent a different position, depending on who gives orders at court. “Independence” of our consultants⁷ is thus reflected in their ability to act, without shame, as advisers and collaborators of a dictatorship, and to be at the top of the pyramid of state administration, which is turning into a service for barons.

The change in the environment toward transitional objectives – a market economy and political liberalism – by no means can be driven by either barons or experts from the camarilla. The former because they have no interest in it. while the same applies to the latter, except that for lack of interest, they are shallow both in terms of expertise and intellect. The lack of ethics cancels the entire expertise.

After all, how could it happen otherwise that, with all references to reforms, we are returning to the position of a corporate state? The difference in the manifestation of this phenomenon so far is that it is no longer socialist in nature, with impersonal bureaucrats acting as heads of particular segments of the economy and society, but is beginning to resemble other countries in which governing parties and big business together have parceled out the national economy. And this is far from all freedom and democracy, which are essential for liberal capitalism as an order which is based on free initiative and equal rights for all, without privileges.

⁷ A consultant is a person whose job is to give advice in exchange for financial compensation. Accordingly, a consultant is by definition in someone's service. Hence, an “independent consultant” is a contradiction *in subjecto*.

Radovan Jelašić

Macroeconomic Theme I

PRIVATIZATION OF BANKS – WHAT NEXT?

Since May this year up to the moment of writing of this article, the privatization of three banks (Jubanka, Novosadska banka and Kontinental banka), which was announced a long time ago, and which falls within the exclusive competence of the Government of the Republic of Serbia, is at a standstill, and the question arises as to what is (not) being done in that respect. The second phase of the restructuring of banks has collided with the political establishment, and the privatization of banks has been halted at the worst possible phase for taxpayers, which at the same time happens to be the most comfortable phase, not only for the former management of these banks, but also for the State which has become their major owner; hence, privatization is being permanently postponed. Still, only general managers have detailed insight into the financial standing of these enterprises, while shareholders, including the State, do not show much interest in the banks in which they hold shares. But, what is going on exactly in these banks?

- *Members of managing and supervisory boards* – at the close of the last and the beginning of this year the Government appointed its representatives in managing and supervisory boards of banks that were designated to undergo privatization. But the process of appointment of these officials implied that politics would play a key role in management of these banks. And while it took the Government of Serbia only two-three weeks to adopt the banks restructuring strategies, the debate on candidates for state representatives in these banks lasted nearly three months. This was probably one of the reasons why members of managing and supervisory boards of these banks have not begun submitting reports on their work to the Agency to this very day; they probably answer to their political party which fought their appointment. Finally, even such reports are welcome, implying a certain level of interest and comprehension of responsibilities comprised in the position of a board member. All in all, the inmates are running the asylum, and it is hardly surprising that after a strong initial opposition, many general managers now hope for additional debt equity conversion, which is in itself to a certain extent suspicious.
- *General managers* – After last year's ownership transformation, when claims were converted into shares in ownership, with a view to starting privatization within six months, only in the Vojvodjanska banka was the general manager dismissed from his position. In all other banks, old general managers had their term of office extended, which once again confirmed that the state has no intention to pursue any considerable influence on the work of these banks. Old general managers came to

terms with new members of managing and supervisory boards in a very short period, and on that basis they reinforced their old executive positions in these banks. These general managers know best what actions have to be taken for the privatization process to be completed as quickly as possible, but nevertheless they have done little in that respect so far.

- *Agency for Deposit Insurance, Rehabilitation, Bankruptcy and Liquidation of Banks (hereinafter: Agency)* – The Agency shall have a key role in the second phase of the restructuring of the banking sector, both as the accountable manager and on behalf of the State, i.e. the owner of these banks, and as organizer of the entire privatization process. Moreover, the Agency shall possess the most detailed analysis of every single bank and pursue management on that basis. Only in that case the National Bank of Serbia (NBS), as a supervisory body, can be sure that the responsibility of managing liquidity and solvency of these banks is in good hands. For well-known reasons in relation to the election first of the members of the Agency Council, and then of its executive director, which was for the most part due to the fear that the NBS would seize too much power in this institution, as well as to the lack of understanding of the role the Agency shall have in the entire restructuring process of banks, this institution has never taken the position provided for under the Law.
- *Potential buyers* – Buyers, or better put “interested persons” are always present, especially if such interest costs nothing. However, one thing is certain: neither the State (Agency) knows exactly what it is selling, nor do buyers know what they are buying, while the entire process of setting the selling price will certainly take another six months. Whether these banks will be attractive in their offer, in terms of clients, employees, network of branches and information technology, will depend primarily on the final price and state guarantees. And until the State puts its cards on the table, the story of “potentially interested buyers” will keep on going, without concretization of plans, whereby the pre-privatization processes is a paradise for management, a fact confirmed several times so far in the real sector.

All in all, banks, both those whose privatization is at issue for months and those whose future is still uncertain, operate following good old customs and under old management, in spite of the fact that the State has not only rights, but also certain responsibilities as one of the main, if not the major shareholder. At the same time, the Agency is more absorbed in its own problems instead of managing these banks in the full sense of the word, while the State does not even know exactly what are the rights and responsibilities of members of managing and supervisory boards.

Privatization will not occur by itself, but will be more a result of efficient work of several actors, in particular the Agency, Ministry of Finance, Ministry of Privatization, and to a lesser extent of the Government, i.e. the NBS. What are

the key prerequisites for the final sale to be completed within 12 months, i.e. for privatization of banks not to end up as dead letter?

- *Appointment of a privatization adviser* - Formal appointment of a privatization adviser following a three-month delay will certainly be an important psychological signal for all three previously mentioned banks that countdown has started. Existence of an institution in charge of selling will affect the list of activities necessary in the pre-privatization process to be created soon. And then the hot potato will be passed back to the Ministries, i.e. the Agency, which are in charge of the fastest and most efficient implementation of the necessary actions.
- *Clearing of balance sheets* – This will certainly be one of the key activities in the privatization process, and banks will have to carry out most of the work, following the instructions of the privatization adviser, i.e. the Agency. The seemingly simple task of settlement of debt-creditor relations must not be underestimated, as these are moments when debtors and creditors meet for the first time after more than ten years. Similar efforts often have not lead to the desired results, because certain debtors, in particular those who could afford to, i.e. those in direct or indirect state ownership, were not responding to the creditors' demands. Some negotiations will have to be held with representatives of the International Financial Corporation (IFC), which has claims in the amount of nearly EUR 60 million toward several Serbian banks, whose ultimate fate has not been resolved as yet.
- *Resolution of the problem of irrevocable claims* – After balance sheets have been cleaned up, the main question will be what to do with irrevocable claims, primarily towards debtors in major state ownership. And while complete write-off of these claims would produce negative capital on the side of liabilities, valuation on the basis of nominal amounts is far from realistic. And since the privatization of the majority of such debtors is still so many empty words, without any concrete actions being taken, the only solution would be to remove these claims from balance sheets, while possible negative capital would be supplemented with state bonds. It is important to stress that this is not a bank restructuring cost, but the indirect price of postponed implementation of reforms in the real sector, which reflects on banks. Banks could recover their claims to a certain extent, but the debtors' lobby, which still has indirect support from the state, will once again cost the tax payers one million US dollars.
- *Coordinated work between the Ministry of Finance and the Ministry of Privatization* – The privatization of banks inevitably increases the pressure on the real sector in terms of the implementation of necessary reforms. And as long as the Ministry of Privatization deals exclusively with the sale, and not with the restructuring of enterprises, which should be the main goal of the transition, the privatization process in banks will drag on indefinitely, i.e. to the detriment of banks, in particular of those in state ownership. It is easiest to close a "successful" sale of enterprises whose complete debt was previously written off by a state-owned bank, while

other banks recover their claims in full. Cutting costs of the state with a view to a “successful” sale of enterprises is directly footed by the Ministry of Finance, i.e. the taxpayers.

- *Political will* – Without political will, the privatization of banks will take a lot more time. Many who advocate privatization will change their position several times, because when the privatization process in banks finishes, it will not be possible any longer to sell enterprises for one or three Euros. No bank with major foreign ownership will sit idle, watching its great debtor being privatized without any consultations with the bank, with such a process not bringing any revenue to the bank. Not to mention claims toward enterprises that went bankrupt. Privatization of banks will certainly improve transparency, not only in the financial but also in the banking sector, which, to be honest, is not very attractive for double dealers who are traditionally used to making profits on exchange differentials.

All in all, the general impression is that something is awaited in the process of privatization of banks, although there is still plenty to be done in a macroeconomic environment that is not so favorable.

Editors: Aleksandra Jovanović
Tanja Mišćević
Author: Oliver Radosavljević

Institutional Theme I

HARMONIZATION OF SERBIA

The G 17 Institute has decided to present a simplified cross section of the legal framework which is in force mainly in the Republic of Serbia, through a series of articles in the Economic Review within the project ***Monitoring of Institutional and Legal Reforms***. This presentation aims to examine the development and modernization in certain legal areas and the dynamics of adoption and harmonization of the Member Republics' regulations with international standards, in particular those in force in the European Union (EU) and those which fall under the World Trade Organization (WTO). At the same time, the G 17 Institute is planning to provide all interested readers with simplified directions on how to make a harmonigram, and to explain how the harmonization process shall be monitored.

The presented data has been examined on the basis of available documents and the G 17 Institute's reports, in particular those published in the Economic Review, various documents of the Serbian Ministries and reports released by international organizations operating in our country, such as USAID, World Bank, FIC, EBRD, SCEPP, PricewaterhouseCoopers, etc.

Of great assistance were the authors of the AIA reports on legal reforms¹, as well as experts of the Institute for Comparative Jurisprudence, CLDS, etc. In this issue we are going to analyze the harmonization of the legal framework for public procurement and for the area of telecommunications, postal communication and broadcasting.

PUBLIC PROCUREMENTS

Public procurement regulations have a relatively short tradition in our legal system. The basic provisions of this system used to be dispersed in various legal enactments, which were insufficient to get a general picture of developments in public procurement. Basic issues regulated under the legislation from that period, which had some features of public procurement (minimum competition, basic transparency of regulations, as well as excessive arbitrariness of public servants

¹ SCEPP AIA Reports, www.plac-yu.org

in awarding contracts)² could not provide basic principles necessary for this very important area to function. The importance of this area is confirmed by the fact that public procurement represents some 9% of our country's GDP, making the public sector a leading consumer of the domestic economy.³

The Public Procurement Law of Montenegro, adopted in 2001, stands for a positive example and progress in the area of public procurement. This Law served as a model during work on the Public Procurement Law of Serbia, which was adopted in 2002. This is the Law that we are going to analyze further in this article, including what could be done at the level of the State Union of Serbia and Montenegro.⁴

a) Legal Framework

As we already mentioned, the systems of public procurement are regulated separately in the two Member Republics⁵. This issue has not been discussed at the level of the State Union even after the adoption of the Constitutional Charter.

b) Brief Analysis of the Law

The Public Procurement Law regulates public procurement of goods and services, and classifies procuring entities into four categories: (1) ministries, (2) legal entities established by a budget user with a specific purpose of meeting needs in the general interest, (3) public enterprises and (4) independent legal entities. Public procurement of services is not defined completely, and therefore some public procurements are not covered by the Law (e.g. services of the National Bank of Serbia, contract on supply of services, etc.).

Having examined and evaluated the tenders in the procedure of awarding a public procurement contract, the procuring entity shall select the best tenderer if it has received at least two independent correct tenders from two different tenderers that are not associated entities. Also, the procuring entity shall reject all incorrect tenders; he may also reject all inadequate and unacceptable tenders. This rule applies both to central authorities and to regional and local authorities.

Especially interesting are articles 45 and 46 of the Public Procurement Law, which specify detailed conditions for participation in the award procedure in a specific public procurement⁶. These conditions are mandatory, and each tenderer must fulfill them. Registration for the appropriate activity with the authorized body, a statement that the tenderer has not been convicted of a

² The following laws in Serbia: the Law on Property (FRY), the Law on Budget Realization, the Law on Public Revenues and Expenditures, Ordinance on Administration of Joint Affairs, the Law on Assets in the Ownership of the Republic of Serbia, etc.

³ Approximately 9.5% of the GDP in Serbia and 7.7% of the GDP in Montenegro.

⁴ Other sources used during the creation of this Law are the AIA report "The Development of Public Procurements in Serbia and Montenegro", Gordana Ilic, the World Bank's document "Country Procurement Assessment Report 6/2002", laws and other available documents.

⁵ Serbia: Public Procurement Law (Sl.GL.RS 39/02) adopted on 5 July 2002; Montenegro: Public Procurement Law (Sl.GIRCG 40/01), adopted on 14 August 2001.

⁶ Same conditions are prescribed under article 4 of the Public Procurement Law of Montenegro.

criminal offence or an offence concerning his/her business activity, i.e. that the tenderer has not received an enforceable court or administrative order prohibiting him/her from carrying out business activity, a tax certificate issued by the tax administration, numbering among some of the necessary conditions.

Current practice in participating in public procurement tenders shows that these two articles are the most problematic for tenderers, both because of the time necessary for conditions to be formally fulfilled (numerous documents of tax, police, municipal and other administrative authorities) and because of frequent non-understanding of all necessary conditions that must be satisfied. For this reason, these articles in public procurement laws in both republics are seen to be supplemented, in order to provide detailed explanations, or to get over these practical shortcomings over time, through permanent training.

As far as the mechanisms of the protection of tenderers' rights in the system of public procurement in Serbia are concerned, this is regulated through the Commission for Protection of Tenderers' Rights, which processes requests for protection of tenderers' rights. Before submitting a request to this Commission, it is necessary to fulfill conditions prescribed under the Law. This is a positive development, as tenderers and their rights enjoy protection, although it requires specific interpretation of time limits and of certain inconsistencies that especially bother the tenderers.

c) Regulatory Function – Public Procurement Office

An important novelty in the Public Procurement Law is the establishment of the Public Procurement Office as a special organization of the Government of the Republic of Serbia, which shall insure proper conditions for development of a cost-effective, efficient and transparent system of public procurements, induce competition and equality of all tenderers, and reduce corruption⁷. An important progress toward understanding necessary conditions, models or criteria for public procurement concerns the fact that all necessary information is now available on the Public Procurement Office's web site.

A request for protection of the tenderer's rights may be submitted in any phase of public procurement procedure to the Commission for Protection of Tenderers' Rights (Commission), which has been founded within the Office⁸. The work of this Commission is regulated by a special act. The Commission reports on its work to the Government and the National Assembly of the Republic of Serbia on an annual basis.

d) Recommendations

Some recommendations for the existing system of public procurements would be:

⁷ www.ujn.sr.gov.yu and www.nabavka.cg.yu.

⁸ See: Decision on Criteria for Establishing the Public Procurement Commission (Sl.GI.RS 39/02)

- Improvement of efficiency in the public procurements procedure
- Engagement of independent auditors on an annual basis and auditing of public procurements
- Permanent training of human resources, and especially awareness raising with regard to the significance and functioning of public procurement, since, according to domestic experience, an untrained and unspecialized administration is the reason for numerous weaknesses;
- Prospects for adoption of the Public Procurement Law at the level of the State Union. The Laws currently in force in Member Republics will have to be harmonized with this Law, which should not be a problem, as both Laws are based on the same grounds, i.e. the EU Directives and other sections of *acquis communautaire*.
- The task of the Public Procurement Office is further standardization of documents, since the entire idea of public procurement is new in our society, and existing practice is underdeveloped and unexplored.

Most enterprises, especially SMEs, still hesitate to cooperate with the public sector. Such enterprises do not have much trust in how public tenders in this area are run, stressing that time and costs of participation in tenders, as well as arbitrary decisions on awarding public procurement contracts additionally diminish confidence in the development of public procurement. The possibility of corruption in public procurement must also be borne in mind.

A properly organized system of public procurement could save considerable public resources and taxpayers' money, while some positive examples and official statements make us believe that public procurement in Serbia will progress in that direction.

TELECOMMUNICATIONS AND POSTAL TRAFFIC

After extended work on the draft of the new law, numerous amendments proposed to the Parliament and strong influence of the international community, in particular the European Commission, a new and modern Telecommunications Law came into force in early May 2003. This Law is to a great extent harmonized with European and international telecommunications standards.

This is a very innovative Law which has created a completely new ambient in an area which is considered, both in legal and economic terms, one of the most attractive and most dynamic areas of the economy.

TELECOMMUNICATIONS

a) Legal Framework

The area of telecommunications used to be regulated under the Federal Law on Communication Systems, a legal document that comprised common provisions for telecommunications and postal traffic, and which for the greater part contained outdated solutions. The legal environment and tendency to harmonize this area with international standards and EU legislation inspired the adoption of

the new law, but this time at the level of the Republic of Serbia. As a result, the new Telecommunications Law of the Republic of Serbia has been adopted⁹.

As far as modern solutions included in this Law are concerned, it is especially important to create and adopt the following documents:

- The Statute of the Telecommunications Agency, which, among other things, specifies organization and systematization of the Telecommunications Agency.
- Regulations and by-laws that shall define license issuance policy in the area of telecommunications.

b) Regulatory Function – the Telecommunications Agency

The adoption of the Telecommunications Law inspired dynamic legal reforms in this area, creating conditions for a free and open market and prohibition of monopolies, as well as improvement in the quality of services. One of the great novelties is the founding of the Telecommunications Agency as an independent regulatory body. Generally speaking, the main task of such bodies (which are present in other laws and draft laws, as well) is to follow developments in standardization in this area. The basic feature of such bodies, including the Telecommunications Agency, is that they are self-financing entities, and therefore politically and financially independent from other institutions, which is a *conditio sine qua non* for dealing with vital issues in a specific area, in this case telecommunications¹⁰. This regulatory body and universal service present significant novelties introduced by this Law.

Universal service refers to a set of basic services of a particular quality and volume which should be available for all within public telecommunications networks at acceptable prices (Art. 4, p. 15 of the Telecommunications Law, Sl.Gl.RS 44/03).

c) Reasons for Adopting a New Law

The Telecommunications Law is for the most part in compliance with international standards and the principles of *acquis communautaire*¹¹. Further improvement of publicity in work is recommended, as well as strengthening of the principle of objectivity and non-discrimination that will be achieved through proper enforcement of this law and accompanying regulations.

Another reason for the adoption of this Law lies in the fact that telecommunications and postal services are now regulated separately.

Moreover, this Law aims to "...encourage competition and further market development, to cancel monopolistic positions (which will last until 2005) and

⁹ Official Gazette of the Republic of Serbia 44/03

¹⁰ Vassilos Karayannis, "Telecommunications Universal Service in the Law of Community", Cahiers de droit europeen, 2002, no. 2-4, pp 315-376.

¹¹ Acquis communautaire is a collective term for EU regulations.

create the principle of safe issuance of frequencies for operators and electronic media”, as defined in the exposition of this Law.

Besides the Telecommunications Agency, the main competences in the area of telecommunications belong to the Ministry of Transportation and Telecommunications of the Republic of Serbia¹².

POSTAL TRAFFIC

The legal framework is still not sufficiently defined and completed. For this reason, the priority in the area of postal traffic is finalization of the Draft Law on Postal Services, which includes the EU recommendations relevant for harmonization of this area with international standards and *acquis communautaire*.

The Draft Law also foresees the Agency as an independent regulatory body. Special attention is paid to the issue of universal services and provision of reserved service for the transport of mail of certain weight.

The Draft Law¹³ foresees universal postal service as the minimum of postal services that are regularly provided on the whole territory under equal conditions for all customers within the prescribed standards of quality for these services and at a reasonable prices. In postal services, universal service involves admission, transfer and delivery of letter mail up to 2 kg, i.e. parcels posted up to 10 kg in inland traffic, i.e. 20kg in international traffic.

One of the objectives of this Draft Law is to set the rules of competition in the market of postal services for foreign and national postal operators.

The enforcement of this Law entails work on adoption of the Statute of the Agency for Postal Services that shall define organization and systematization of work of the Agency.

The Ministry of Transportation and Telecommunication of the Republic of Serbia, which is in charge of creating and proposing the law, aims to intensify investment activities and operators in the development of telecommunications and postal infrastructure.

¹² www.msaotel.sr.gov.yu

¹³ Available on the web site of the Ministry of Transportation and Telecommunication.

Macroeconomic Theme II

SURVEY ON THE INVESTMENT AND BUSINESS CLIMATE IN SERBIA AND MONTENEGRO

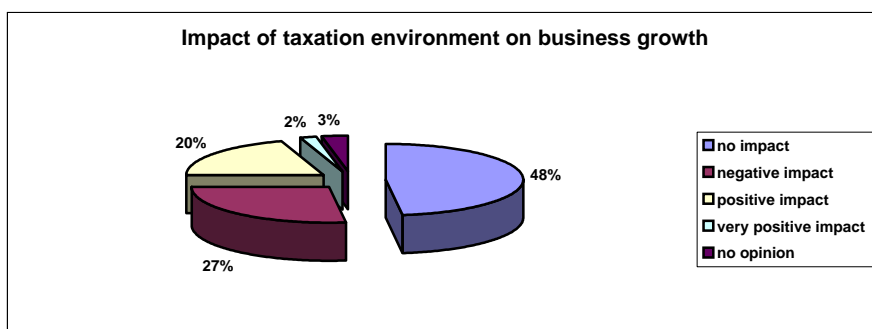
The Survey on the Investment and Business Climate is a mutual project of KPMG d.o.o. Beograd and AmCham Serbia and Montenegro. Due to the fact that we are experiencing the 3rd year of uninterrupted inflow of foreign investment, it was felt that the impact of reforms on present and potential investors should be investigated. We believe that the survey and accompanying results are interesting both for present and potential investors, as well as for local companies, who are in search of strategic foreign partners.

The Survey on the Investment and Business Climate in Serbia and Montenegro was carried out between April and May 2003. Questionnaires were sent out to foreign legal entities operating in Serbia and Montenegro (SCG). Companies surveyed covered all of the main industry sectors. In this article we set out the key findings of the survey.

Companies were questioned about their experience in dealing with the Government Authorities, before their establishment in SCG and their experience since. 52% of respondents were satisfied with the support they received while establishing a presence in SCG. For 37% of respondents, Government support failed to meet expectations, while only 2% felt that the support given exceeded expectations. Only 25% were satisfied with their dealings with Government authorities, while 48% were unsatisfied but saw improvements.

Foreign companies had better experiences in their dealings with local suppliers of goods and services. 48% of respondents felt cooperation was at least satisfactory, with a further 34% dissatisfied but noting improvements. This testifies that the professionalism and entrepreneurial spirit of local partners are rated comparatively well. On the other hand, 34% of respondents feel that the general availability of services (e.g. express courier, postal, telecom, health, travel etc) has not improved compared to previous years, 59% felt the availability of services has improved and 7% felt that it has improved significantly. It is evident therefore that opportunities to increase the availability of such services exist.

The taxation environment is a key factor for foreign entities investing in new markets. Almost half of the respondents (48%) felt that the current taxation environment has no impact on their business development. 27% of respondents believed that the taxation environment had a negative impact on their business' future expansion, with 20% believing it had a positive impact. Companies, however, may not yet have had sufficient time to feel the impact of recent changes in tax legislation on their business.

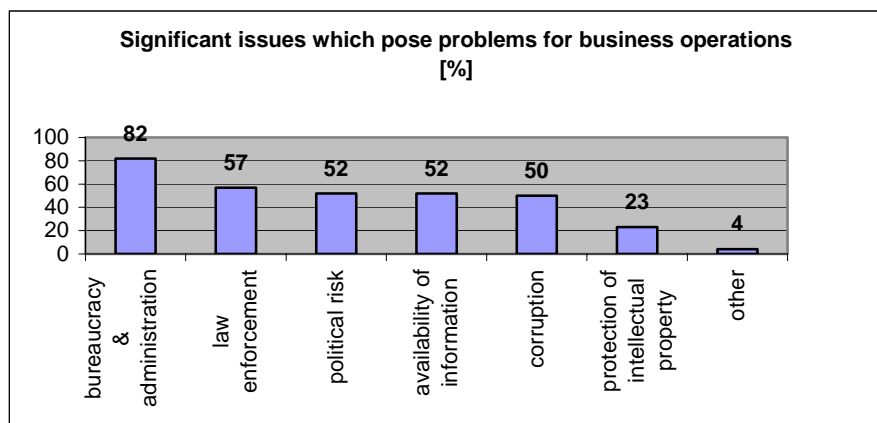


Staff recruitment is an area, which is proving difficult for investors: 77% of respondents had difficulty in recruiting staff. However, we noted that larger companies had less difficulty in recruiting suitable staff. It is unclear where the origin of this problem lies. One possible explanation relates to the migration of mainly young educated professionals, which peaked over the past decade of economic crisis. However, this is an area that requires further investigation.

Companies are still having difficulties with bureaucracy. Respondents referred to the slow and inefficient state administration apparatus and the slow pace of proceedings in the commercial courts. Other comments related to the obvious lack of stimulation and motivation mechanisms for clerks and middle ranking officials, and interdepartmental conflicts within institutions. According to respondents, both issues have a direct impact on the overall efficiency of the bureaucratic apparatus and professionalism of the staff. Therefore, recent initiatives of the Government Authorities aimed at the simplification of administrative procedures represent a positive move. Needless to say, the Government should not halt at this point in their efforts to reform the bureaucratic apparatus, but rather take an even more comprehensive approach that would cover organizational, technical and human resource aspects.

Companies also believe that inefficiencies in the legal system pose problems for business operations. These inefficiencies include inadequate enforcement of existing laws, slow implementation of new laws, and unclear interpretation of new laws and lack of intellectual property protection. Results imply that

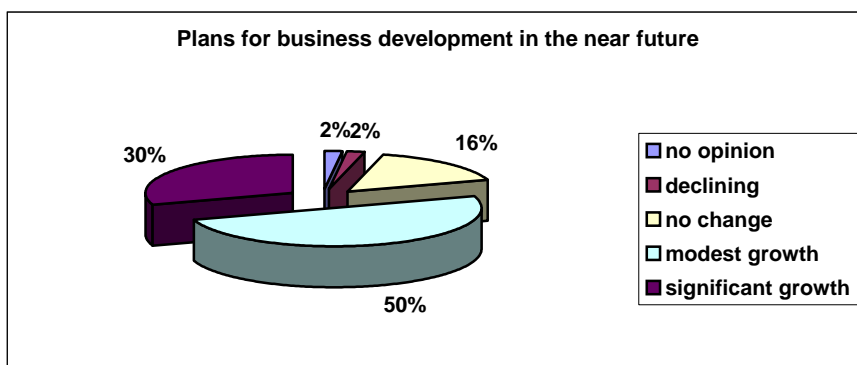
companies feel that it is very difficult to make well thought-out business decisions in a legal environment colored with uncertainty and ambiguity. Hence, improvements in the legal framework are an imperative for future business development.



45% of respondents reported that the banking and financial services sector was the area where the most significant improvements were noted. However, 25% of the surveyed remained dissatisfied with the sector, with only 38% expressing their satisfaction.

Other areas where progress has been noted include the provision of macroeconomic stability, development of infrastructure and telecommunications and the fight against corruption and organized crime. The fact that the survey was carried in the months following the assassination of the late Prime Minister Zora Djindjic, when Operation Sabre was at its peak, could have influenced the responses by placing the fight against corruption and organised crime relatively high in importance.

Despite the concerns outlined above, 50% of respondents are planning modest growth, with a further 30% expecting their business to expand significantly. Furthermore, 85% of companies with manufacturing or service operations (i.e. companies that are no longer solely representative or sales offices) envisage modest or significant growth in the future.



In summary, it appears that foreign companies are still experiencing difficulties in carrying out their business in Serbia and Montenegro. The legal system and recruitment were areas where particular difficulties were being experienced. However, foreign companies still express optimism about the market. It is up to the Government and Legislative authorities to maintain and perhaps to increase the pace of reforms to ensure that this optimism is not unfounded.

If you would like to find out more about this survey, please contact KPMG Beograd, Studentski trg 4 or e-mail info@kpmg.co.yu

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act upon such information without appropriate professional advice after thorough examination of a particular situation.

Ana Djorić, LLM

Institutional Review

ARE OUR AIR LINE PILOTS GOING TO LOSE THEIR LICENSES BECAUSE OF THE ESTABLISHMENT OF THE EUROPEAN AVIATION SAFETY AGENCY?

General Remarks on Air Transport

Air transport is one of the largest world industries which generates the income of over US\$ 300 billion a year; the economic significance of this industry is particularly great as the transportation of passengers by air contributes to the development of tourism, while the transportation of goods by air contributes to the development of world trade, international investments and the economy in general.

Of all the different modes of transportation, air transport has shown by far the largest increase over the last twenty years. According to the available data, expressed in passenger/kilometer, air traffic has increased by some 7.4% a year on average since 1980, while traffic handled by EU airports has shown a five-fold increase since 1970. 25,000 aircraft fly the sky above Europe every day, and in view of growth trends, this figure is expected to double every 10-15 years. Although the skies are vast, enormous and increasingly frequent delays are a clear sign that this space is also facing the problem of congestion which is well known in rail traffic and especially in road traffic¹.

Airlines expect air traffic to nearly double by 2010. To sustain such growth, air-traffic management will need to be reformed in order to guarantee sufficient airport capacity in the Union which is due to be enlarged by ten new Member States in 2004.

According to the forecasts of future development of transport in this region², air traffic is expected to increase faster than any other mode of transport over the following 25 years.

However, current developments in our country are completely opposite: civil aviation is obsolete, outdated, indebted and in overall stagnation, both compared with Europe and the rest of the world and with the Western Balkan region and Southeastern Europe. Pilots say³ that our airlines are heavily indebted and operate with an obsolete and inefficient fleet, an outdated manner of work and

¹ White Paper : European Transport Policy for 2010: time to decide", COM (2001) 0370, p. 38 and http://europa.eu.int/comm/dgs/energy_transport/index_fr.html

² See: Regional Balkans Infrastructure Study – Transport, REBIS transport final, June 2003, p. 50

³ <http://www.yalpa.org/chairman/avioprevoznici.htm>

old fashioned mindsets, amid unresolved social problems. Ownership transformation has not even started yet. A decision has to be made whether to privatize our national airline JAT completely or only some of its parts. Besides privatization, the company should be transformed, which is a long and complex process, in order for a competitive company to be created which will be able to win its place on the market, since regional trends indicate that all airlines are scheduled for privatization sooner or later. The EU single market is open for all operators, like the regional market of the Balkans, with the exception of Montenegro⁴.

Especially sensitive is the question of the future of airports, which are currently under state ownership.

Yugoslavia used to be at the very top of European aviation, but in the past several years it has dropped to the very bottom, for well known reasons; although this does not mean that we should sit back and do nothing to improve the situation.⁵

Our pilots are especially concerned about the establishment of the new specialized Agency at the level of the European Union that will be responsible for safety of air navigation that is due to start operating in late September 2003. Does the establishment of such an Agency mean that the licenses of our pilots, issued under our country's regulations, will be revoked and that they are going to remain grounded in the upcoming period?

The European Aviation Safety Agency

The European Aviation Safety Agency⁶ (hereinafter Agency) has been established by EU Regulation⁷. The mission of the Agency is to assist the Community in:

- establishing and maintaining a high, uniform level of civil aviation safety and environmental protection in Europe;
- facilitating the free movement of goods, persons and services;
- promoting cost efficiency in the regulatory and certification processes;
- assisting Member States in fulfilling their ICAO obligations on a common basis;
- promoting world-wide Community views regarding civil aviation safety standards.

The Agency will develop its know-how in all the fields of civil aviation safety in order to assist Community Institutions in the development of legislation and

⁴ Rebis, op.cit p 108

⁵ <http://www.yalpa.org/chairman/zakon.htm>

⁶ Agence europeenne de la securite aerienne –AESA (fr), European Aviation Safety Agency – EASA (en.); the Agency is a legal entity, with administrative and financial autonomy. For more information see: http://europa.eu.int/agencies/easa/index_fr.htm

⁷ Regulation (EC) No 1592/2002 on common rules in the field of civil aviation and the creation of the European Aviation Safety, OJ EC L240 of 7 September 2002. This regulation specifies the structure of the Agency, the way its bodies will operate, decision-making processes and resolution of possible conflicts.

implementation of rules relating to the safety supervision of aeronautical products, as well as of organizations and personnel involved in their operation and of any other related area.

At the beginning, however, and in spite of various information that could be heard publicly, the Regulation establishes only the basis for Community action in relation to the certification of aeronautical products and of organizations and personnel involved in their design, production or maintenance. Later on, the Commission, with the Agency's assistance, will progressively propose necessary amendments to the Regulation to extend its scope to all other domains of civil aviation safety in order to ensure better functioning of the entire system.

The Agency is also given powers and an appropriate organizational structure to manage certain executive tasks, where collective action would be more effective than individual action by Member States. At the beginning, it shall issue type certificates for aeronautical products. It will assist the Commission in the monitoring of the application of common rules, and provide its technical assistance in contacts and negotiations with the aeronautical authorities of third countries and international organizations competent for civil aviation safety and environmental protection. Finally, it will be able to assist the Community and its Member States with their co-operation and assistance activities with third countries.

In order to be sure that decisions on safety issues are free from all political interference, decision-making must be in the hands of a neutral and independent decision-maker invested with the necessary powers. This is why the safety decisions of the Agency will be taken by its Executive Director⁸.

As aviation cannot be artificially stopped at the Community's borders, safety does not end there, either. For this reason, the Regulation allows for the possibility of various partnerships and contracts on cooperation with third countries. Thus, the Agency shall be open to the participation of European third countries, which are contracting parties to the Chicago Convention. Cooperation with third countries will be based on contracting relations⁹.

As far as flight crew licensing is concerned, it is foreseen that the essential requirements that aircraft, i.e. flight crews must fulfill should be developed within one year after the going into force of this Regulation¹⁰.

The Agency shall start operating as of September 28, 2003.

During the transition period of 42 months following September 28, 2003, Member States shall continue to issue certificates and licenses. In the meantime, the Agency shall adopt new appropriate regulations¹¹.

⁸ At the meeting held in Brussels on July 11, 2003, the Management Board of the Agency, at the Commission's proposal, appointed Patrick Goudy as executive director – see *Midday express* of July 14, 2003.

⁹ Art. 55 of the Regulation

¹⁰ Par. 2 of the Regulation

¹¹ Art. 56 of the Regulation

Transport in the European Union

From its very beginnings, the European Union, first in the form of European communities, became aware of the importance of transportation, and for this reason the Founding Treaties foresaw a common transportation policy. The Treaty specifically refers to land transport, but the practice of the Court of Justice of the EC confirmed that the EU equally advocates all modes of transport, directing its efforts towards sea and air traffic, as well. To be honest, the very nature of these two modes of transport requires considerable attention to be given to the international environment, since there are only two modes of transport which are international in the full sense of the word: sea and air transport. Land transport, whether we like it or not, is always local, having all characteristics of the continent on which it is conducted¹².

The EU has been developing its common transport policy, but until the 1980s, actions taken in this area were sporadic. The same applies to air transport, where the liberalization of the sector in terms of services, was considered a priority. The EU has heeded the Chicago Convention and the international framework, and the European system was therefore harmonized with international regulations, which makes the situation much easier. From the position of Europe, the system of an open market, which means free access for all interested parties, had to be adjusted, so that measures had to be taken in the area of harmonization and adoption of appropriate instruments to avoid problems that may follow the enlargement of the Union in 2004. Accordingly, the European Union applied the principle of liberalization and not of complete deregulation of air transport. The Accession Treaties comprise several provisions regulating transport. Thus, the Accession Treaty foresees access at two levels, i.e. conclusion of a contract on access to the market of services in air transport and adjustment to the remainder of community regulations as a unilateral obligation of an acceding country.

Obligations of a State that Wishes to Join the Union in the Area of Air Transport

According to the data from the White Paper¹³, the enforcement of community regulations in the area of air transport requires a large-scale air transport office that would be responsible for economic and technical issues. Without such an office, air transport is vulnerable to safety problems. Existing legislation in the

¹² For more information on the unification of international transport law see the special edition of the Uniform Law Review dedicated to the world harmonization of private law and regional economic integration, no. 2003 -1/2, pp 233-32-0; the term "local" should be understood in its wider sense, as continent-related.

¹³ White Paper "Preparation of Associated CEE Countries for Integration into the Internal Market of the Union", Belgrade 2001, The Institute for Economic Sciences and the Friedrich Ebert Stiftung. This White Paper was published to provide necessary assistance to countries that tend to adjust their legislations to *acquis communautaire*, with the main emphasis being on harmonization of regulations governing competition.

Community is based on a market-oriented framework, in which airlines have a wide freedom of operation, and it is not therefore realistic to expect self-control to be a sustainable option. The air transport office must be not only efficient, but it also has to take into account the problems of competition.

The issue of flight licenses is not considered a priority in the White Paper, but merely as a key measure, and only under the Directive no. 91/670 on mutual acceptance of licenses for personnel working in civil aviation¹⁴.

Regulations in the European Union Concerning Pilot Licenses

Since the issuance of licenses has not been regulated yet at the level of the European Union, with Member States still being in charge of setting conditions for acquiring these qualifications, it is necessary to ensure that air transport services operate safely, and to guarantee free movement of these workers throughout the Community. It was therefore necessary to introduce a community procedure for mutual acceptance of licenses and qualifications. This was completed at the beginning of the 1990s through the adoption of Directive no. 91/670 on mutual acceptance of personnel licences for the exercise of functions in civil aviation.¹⁵

In case of divergence with regard to mutual acceptance, each Member State may ask the Commission for an opinion on the equivalence between specific licenses, and the Commission must deliver its opinion within a prescribed deadline¹⁶.

International Standards for Pilot Licenses

International civil aviation has followed the standards and practices on flight licenses since 1948¹⁷.

The first standards on flight licenses were created around 1919. The requirements concerned flight experience and medical ability, and were contained in Annex B of the Paris Convention, that preceded the currently followed Convention on International Civil Aviation adopted in Chicago in 1944 (hereinafter the Chicago Convention)¹⁸.

¹⁴ Op.cit. p 256

¹⁵ Directive 91/670/CEE du Conseil, du 16 décembre 1991, sur l'acceptation mutuelle des licences du personnel pour exercer des fonctions dans l'aviation civile (the Directive no. 91/670 on mutual acceptance of personnel licences for the exercise of functions in civil aviation), OJ EC, L 373 of 31/12/1991 pp. 21-25

¹⁶ Art. 4 of Directive 91/670

¹⁷ ICAO standards comprised in Annex 1 of the Chicago Convention have been enforced in practice since September 15, 1948. 8th edition of the Annex, from November 5, 1998 is in force today. For details see <http://www.icao.int/icao/en/anb/peltrg/peltrg/annex1.html>

¹⁸ Convention on International Civil Aviation or the Chicago Convention was adopted in 1944 and came into force on April 4, 1947. Yugoslavia ratified the Convention in 1954, whereas the text of the Convention was published in the Official Journal of the FNRY, annex 3/1954. The Convention regulates five "Chicago freedoms" of the air which each contracting State grants to other contracting states in respect to scheduled international air services: the privilege to fly across its territory without landing; the privilege to land for non-traffic purposes; the privilege to land passengers, mail and cargo taken on the territory of the State whose nationality the aircraft

The state which issues the license accords the holder of a license the right to conduct certain activities which, if not conducted properly, may compromise the safety of aviation. The State which issues a license shall keep appropriate records.

The License authorizes its holder to conduct certain activities related to aircraft navigation, which require a certain degree of qualification; otherwise, if an aircraft is navigated by an unskilled person, the safety of air transport and of passengers would be compromised.

The Chicago Convention requires the pilot of every aircraft engaged in international navigation to be provided with certificates of competency and licenses issued by the State in which the aircraft is registered. At the same time, the certificates of competency and licenses issued by one contracting State shall be recognized as valid by other contracting States¹⁹.

Standards and Recommended Practices of the International Civil Aviation Organization

There is no such thing as an international flight license. What exists are standards and recommendations which are not binding, but contracting States comply with them in practice and follow them when legally regulating this area.

Standards and recommended practices on licenses which are in force today were adopted for the first time at the Council of the International Civil Aviation Organization (ICAO)²⁰, established by the Chicago Convention on April 14, 1948 pursuant to the provision of Article 37 of the Convention on International Civil Aviation, and are comprised in Annex I of the Convention. These rules – recommendations have been in force as of September 15, 1948²¹.

possesses; the privilege to board passengers, mail and cargo destined for the territory of the State whose nationality the aircraft possesses, the privilege to take on passengers, mail and cargo destined for the territory of any other contracting state and the privilege to land passengers, mail and cargo coming from any such territory.

¹⁹ Art 32-33 of the Chicago Convention

²⁰ See the Convention, Part II, art. 43-66; International Civil Aviation Organization is a specialized UN Agency with a seat in Montreal and regional offices in Paris, Millburn, Lima and Cairo. ICAO objectives and aims are defined in the Chicago Convention (art.44) as follows: to insure the safe and orderly growth of international civil aviation throughout the world; to encourage the arts of aircraft design and operation for peaceful purposes; to encourage the development of airways, airports, and air navigation facilities for international civil aviation; to insure that the rights of contracting States are fully respected; to promote safety of flight in international air navigation, etc. It also has an administrative function (contacts and correspondence with contracting States, provision of technical services, etc.), legislative function (preparation and adoption of new regulations and amendments to the existing rules; conventions; protocols, recommendations; resolutions; standards; instructions in the area of air navigation), and judicial function (arbitration in the resolution of conflicts between two contracting States, whereby the parties in dispute can bring their case to the International Court of Justice in The Hague).

²¹ Recommended practices in force today present the 8th edition from 1998. A new version or new standards are expected to appear in 2004 according to the information available at <http://www.aerolearn.com/halldale/presentations/wats2002/21>.

The ICAO international license does not exist, although it can be heard often that someone possesses an ICAO license. The licenses issued by ICAO contracting States on the basis of best practices and recommendations from Annex 1 are usually referred to as ICAO licenses. For this reason, many believe that there is a specific ICAO license or international license, which is not the case, as such licenses are issued neither by the ICAO nor by any other organization. Each contracting State issues licenses following its own regulations, and in many cases such licenses comply with Annex 1. Contracting State can also render valid a license issued by other contracting States on the basis of bilateral or multilateral agreements, or when other requirements from national legislation are fulfilled.

Annex 1 contains standards and recommended practices in the area of medical ability, competence, experience, navigation instructions and skills. This means that in each contracting State, a pilot, prior to being issued a license, must undergo medical examination and a test of competency. A holder of a license must have previous experience and continuity in air navigation, i.e. in exercising other related activities. It also foresees periodic examination of competency, and recommends appropriate training.

Contracting States are advised to comply with common standards when issuing licenses as this is a way for those who hold licenses to be subjected to mutually comparable, if not identical conditions. This is the meaning of the Annex.

Contracting States shall notify the organization on differences that exist in national regulations relative to standards which are respected in international relations. Such information is necessary for safety reasons.

The text of the Annex may be used in national regulations. Provisions of the Annex have been written in such a way so as to facilitate incorporation, without major textual changes, into national legislation, and wherever possible, the text has only been translated and adopted integrally as national regulation.

The ICAO has released an appropriate guidebook on licenses which is available to all interested persons²².

Flight Licenses in Serbia

a) Current Legislation

The subject matter of license issuing in our country is regulated under the Law on Air Traffic²³ (hereinafter the Law) and accompanying bylaws²⁴.

The Law draws a distinction between an authorized flight crew and a technical flight crew. The flight crew, according to the terminology of the law, is the

²² ICAO Document no. 9379

²³ Air Navigation Law, Official Gazette of the FRY, no 12/98, 5/99, 38/99, 44/99, 73/2000, 70/2000; articles 110-152 within Chapter III regulate flight crew issues.

²⁴ Regulation on qualifications, exams and licenses for aircraft crew, OG SFRY no. 2/80, 31/80, 43/81, OG FRY 12/93, 55/94, 77/94, 46/95, 16/96

authorized flight crew. On the basis of the appropriate license, the flight crew performs precisely defined duties which directly affect the safety of air traffic²⁵.

The Minister in charge of transport issues²⁶ prescribes what kind of training flight crews must undergo, while a flight license is issued and its validity extended by the Ministry of Transportation, i.e. by the center for flight crew training, which is certified by the Ministry to conduct such training. The license contains only valid authorizations. Flight licenses for airline transport pilots, professional pilots, flight engineers and flight navigators are issued for the period of five years, whereby the expiry date of the license always corresponds to the expiry date of the certificate for the type of aircraft which is flown, and this certificate is issued for the period of 12 months²⁷. Flight licenses for special categories of pilots, i.e. hot air balloon pilots, are valid for 24 months.

The Ministry is also responsible for examining competency of flight crews. For that purpose, the Ministry may authorize appropriate professionals to conduct examinations. A flight crew must be physically and psychologically able to perform the required duties, and that ability is confirmed through adequate regular or special medical examinations. Medical examinations are performed in the institution authorized by the Ministry. A flight crew is also examined on a regular basis in terms of professional skills prior to the extension of licenses and certifications and not only prior to the first issuance of these documents. If a person does not meet the prescribed criteria, he/she will not be issued a license. Special examination of ability and skill is also possible in cases where a federal aviation inspector suspects that a person is not qualified to exercise functions in civil aviation. Such an examination must be completed within 30 days.

Flight licenses issued in foreign countries can be rendered valid in our country if our country in general issues that particular type of flight license and certificate.

The Law also provides for the possibility of the license being revoked²⁸.

The Ministry also keeps records of issued licenses²⁹.

²⁵ Art. 110 of the Law

²⁶ Although under the Law this issue falls within the competence of the Federal Ministry of Transport and Telecommunication, following the changes in the state structure, today the Ministry of Transportation of the Republic of Serbia is in charge of this issue (under the Law on the Implementation of the Constitutional Charter, art. 16, the Federal Ministry of Transport and Telecommunication ceased to operate on the date on which the Constitutional Charter went into effect. Federal laws in the fields that fall within the jurisdiction of institutions of Serbia and Montenegro under the Constitutional Charter shall be applied as legal acts of the State Union, while acts which do not fall within the fields which the Constitutional Charter has defined as the jurisdiction of Serbia and Montenegro shall be applied after the Constitutional Charter comes into effect, as general acts of the Member States except those laws to be declared null and void by relevant bodies of the Member States (Constitutional Charter, art. 23).

²⁷ For a pilot of transport aircraft older than age 40 this certificate for specific type of aircraft is valid for six months.

²⁸ When a pilot has received a security measure due to a criminal offense or if a pilot has received an enforceable court or administrative order prohibiting him/her from carrying out business activity – as long as such measures are valid; if a pilot is physically or mentally disabled for performing duties and tasks for which the license has been issued; if it has been discovered through the examination procedure that the pilot is incapable of professionally performing duties for which the license has been issued - Art. 118 of the Law.

²⁹ The Register of Flight Personnel

b) Under the Draft Law on Aviation

The Ministry of Transportation and Telecommunication of the Republic of Serbia has prepared the Draft Law on Aviation of FR Yugoslavia³⁰. The Draft Law has not entered parliamentary procedure, though. It foresees the establishment of a Civil Aviation Office (hereinafter CAO) as an office of the FRY outside of the structure of the Ministry. The Ministry shall be responsible for license issuing³¹.

The CAO shall prescribe conditions for the issuance of flight licenses such as age, qualification, skills, experience, physical and mental health and general competency³².

The Draft Law foresees the possibility of validation of foreign licenses through validation letters.

The CAO shall keep a register of flight personnel³³.

The CAO may revoke the license or suspend it for a certain period of time under specified conditions.

The CAO may require the holder of a license, either locally issued or validated, to undergo tests (theoretical and practical) in order to examine his/her competency, or medical or psychological examination in order to assess his/her abilities.

State Plans in the Area of Air Transport

In the Strategy of Economic Development of Serbia until Year 2010³⁴, what is foreseen in the area of air transport is the establishment of a civil aviation authority and membership in international aviation organizations. Our country is the only one in Europe without a civil aviation authority, although by signing international conventions it has undertaken to establish such authority. A civil aviation authority would draft the plans of development of all sub-systems, laws and other enactments and instructions; it would also undertake measures for the improvement of safety, regularity and efficiency of air transport and would establish cooperation with international aviation organizations. This authority would also be responsible for issuing licenses to flight crews and certificates of airworthiness of aircraft, and for organizing inspection offices. The Strategy also foresees harmonization of legal regulations with the EU and ICAO rules and standards.

Investments in the civil aviation sector, according to data released by the Ministry of Transport and Telecommunications would be around EUR 140 million - some EUR 100 billion from the EIB for modernization of air traffic control (safety

³⁰ The Draft Law on Aviation can be found at the web site of the Ministry of Transportation and Telecommunication at <http://www.msaotel.sr.gov.yu/NasTim/NT24.htm>

³¹ Art. 2

³² Art. 24

³³ Art. 25

³⁴ Strategy of the Economic Development of Serbia until Year 2010, the Government of the Republic of Serbia, MNTR, Belgrade, 2002, Volume I, p 128.

reasons, above all), and about EUR 40 million for the reconstruction of the Belgrade Airport funded by the EBRD³⁵.

What Has Been Done So Far?

Cooperation with the ICAO has been reestablished recently, and information on what is necessary in order to restore membership has been collected. Our country should adjust to the “open sky” policy, and get the instructions on what has to be done in that respect in order to regain control over air space above Kosmet at altitudes over 10,000 m. This would increase revenue from charging crossing. To that end, it is necessary to invest into the entire system of air traffic control, in particular in modern equipment. Over the past years crossings were charged regularly, but the entire revenue never reached those for whom it was intended³⁶. Therefore the EIB approved our country a credit of EUR 100 million for the modernization of air traffic control.

The implementation of the project “The Gate of Serbia” shall start at the beginning of this year owing to the EBRD credit in the amount of EUR 30-40 million.

In November 2002, SCG restored its place in the European Civil Aviation Conference (ECAC)³⁷.

Proposals of the Yugoslav Association of Line Pilots

The proposal of the Yugoslav Air Line Pilots Association (YALPA)³⁸ from March 2001 was to follow the example of Croatia, the Czech Republic, Slovenia and

³⁵ Project “The Gate of Serbia” foresees the uniting of the old and the new airport buildings, which would mean modernization of the airport and its adjustment to a greater number of passengers. The location of the Belgrade airport is interesting in many ways, in particular for its closeness to the Danube River, i.e. Corridor 10 – railway and road networks simply suggest the need to form a cargo center for delivery of goods, which would not only meet the needs of our country, but also of the entire region. For details see *Ekonomist* no. 161, TEMA BROJA “Cardak na nebu”: (Tower in the Sky), <http://www.ekonomist.co.yu>

³⁶ This revenue should go to the Federal Air Traffic Control Office, but it used to serve for funding some other needs of the state.

³⁷ ECAC – European Civil Aviation Conference was founded in 1955 with a seat in Paris. Its mission is to improve European air traffic, especially in terms of economics, i.e. in terms of harmonization of rates, optimization of transport capacities, more rational exploitation of fleets. The ECAC has a close cooperation with the Council of Europe, with the aim to promote permanent development of safe, efficient and sustainable systems of European air transport following environmental standards. The ECAC uses services of the ICAO Secretariat. The ECAC adopts decisions, recommendations and political declarations. Its acts are not legally binding for Member States. ECAC’s activities are of a consultative nature. Thus, some of the adopted acts need to be transformed into a national regulation or policy to be binding for third persons. The ECAC gathers 41 states. For more information: <http://www.ecac-ceac.org>.

³⁸ YALPA - Yugoslav Association of Line Pilots was founded in 1962. This organization, representing over 400 pilots, was established to protect the professional interests of Yugoslav pilot members. In 1972 YALPA became a member of IFALPA – International Federation of Air Line Pilots. YALPA’s mission is to promote development of a unified view on all matters of concern to pilots, to further the exchange of information and ideas,

Poland, i.e. to apply a German system of organization of the civil aviation authority, and in that sense appropriate initiatives have been taken. Germany offered assistance in that respect.

This task should be assigned to the Ministry of Transport and Telecommunication of Serbia as an institution in charge of transport issues. The Ministry comprises the Direction for Air Transport, while 98% of pilots and 90% of passengers take off from the Belgrade Airport.

Pilots have suggested that the new Law should be brief and adopted as soon as possible. Aware of the complexity of this task, they have also suggested that professionals of different profiles should take part in its implementation, mutually cooperating toward their joint objective, that is, adoption of a quality law that would be applicable in practice, to the satisfaction of all interested parties and the benefit of the state. They have proposed that the civil aviation authority should be organized very simply, as an office or direction which is modern in terms of human resources, technology and ideas.

What Has to Be Done Prior to Accession to the European Union

Our country has not signed the Stabilization and Association Agreement yet. However, some issues have already been addressed.

With regard to the sector of transport, endorsement or intent to endorse this Agreement (which is closer to our present situation) means:

1. liberalization of transit and transit without restrictions in road transport;
2. harmonization of transport regulations with *acquis communautaire*;
3. unrestricted access to the market of maritime and commercial transport;
4. harmonization of regulations in the area of air and road traffic with community regulations;
5. restructuring and modernization of transport and other relevant infrastructures;
6. development of the movement of persons and goods, their better access to the market by removing administrative, technical and other obstacles;
7. achieving operational standards comparable with those in the EU;
8. development of the system of transport compatible and harmonized with the system of transport in the Union;
9. environmental protection improvement, reduction of negative emissions and pollution³⁹.

These recommendations should be incorporated immediately into the strategy of transport. They require immediate coordination, at the state level, but they have not been implemented yet. Liberalization of road transit, the guarantee of non-discriminatory treatment for shippers from EU states is still at the proposal stage. Restructuring of ZTP Beograd and division of the enterprise into two parts – one

promote discussion on technical problems, advance the professional status of pilots, enhance the pilots' technical standards, and foster goodwill and friendship among all pilots. For more information visit <http://www.yalpa.org>.

³⁹ Rebis, op.cit.p 110

that will deal with infrastructure and another that will operate services is a key factor of reforms⁴⁰. It also remains for full freedom in maritime navigation and equal treatment of foreign and domestic shippers to be established.

Special attention should be paid to the following:

1. transport policy and coordination, that should be regulated at the state level;
2. further improvement of transport infrastructures and accompanying measures that should improve safety
3. improvement of transit across the state and reduction of congestion⁴¹.

Conclusion

The establishment of the European Aviation Safety Agency which shall start operating as of September 28, 2003 is not of significance for flight licenses of our pilots at the moment. However, bearing in mind future plans, the work of this Agency should be followed as the adoption of regulations governing this area of activity at the level of the European Union is planned.

SCG is a member of the ICAO⁴², and it is therefore advisable to follow its guidelines in creating new regulations on license issuance, or to adopt them as national regulations, which is much simpler.

The establishment of an Agency that shall be in charge primarily of safety issues in civil aviation raises another question, i.e. the question of compatibility of our regulations and standards that aircraft must meet and standards in force in the EU. It might happen that our aircraft can not fly in Europe any longer because they do not satisfy strict conditions of environmental protection (extensive sound emissions or air pollution).

⁴⁰ Rail traffic in every EU Member State (and consequently in every country that tends to become a member) must be organized in line with the Directive no. 91/440, which foresees division into two parts, one responsible for infrastructure and another responsible for transportation. Institutional division is not mandatory, but the financial accounts of these enterprises will certainly be separated (especially sub-accounts), they will operate following sound financial principles and international groups operating in the area of combined transport of goods on international relations will be given the right to access the rail network. This reorganization of the railway also has its economic aspects considering that cabotage is foreseen on the single European market as of January 1, 2006, while its full establishment is projected for January 1, 2008. The opening of cabotage will put all enterprises that fail to adapt to market-oriented operating of a business in a very unfavorable position, as they will not be able to respond to competition, while governments will not have any instruments at their disposal to protect them. It is therefore necessary for our new railway law to follow these guidelines, and for the railway to get reorganized to the greatest possible extent and to begin operating on the basis of market principles.

⁴¹ Rebis op.cit. p 112

⁴² <http://www.icao.int/eurnat/>

Dušan Dinić¹

Macroeconomic Theme

COMPETITION POLICY IN CENTRAL AND EASTERN EUROPEAN COUNTRIES

The endorsement of treaties on accession of the ten countries of Central and Eastern Europe to the European Union that took place at the close of the last year is a good opportunity for the analysis of not only the course of negotiations, but also of the entire fifteen-year association process. Competition policy has had a significant role in this process in two ways:

1. Building of a competition policy is one of the key elements in the transition from a command to a market economy. A functional market economy is a prerequisite for the beginning of association negotiations with the Union.
2. The competition policy plays a vital role in accession negotiations, which are divided into 31 chapters, whereby candidate countries are expected to accept EU legislation in this area, its efficient enforcement and further adjustment to changes that may occur in the Union in that respect.

Competition Policy in the European Union and the Position of CEE Countries

Competition policy in Central and Eastern Europe appeared for the first time somewhere between 1990 and 1993, when parliaments in the majority of these countries passed laws governing this area and when specialized state offices in charge of enforcement of competition policy were set up. Privatization, liberalization of prices and of foreign trade were also important issues on the agenda, as well.

The relation between privatization and free competition policy turned out to be especially ambivalent. They seem to be in agreement, contributing to growth in economic efficiency; however, rapid privatization may end in the cementing of monopolistic structures inherited from socialism, which may easily lead to the abuse of a dominant position. For this reason, a frequently discussed issue during the first half of the 1990s was the influence of the opinions of officials in charge of enforcement of competition policy on decision-making in the privatization agency – should it be only consultative or to a greater or lesser extent binding? Specific solutions that were reached in some countries were for the most part a result of political agreement, and the debate on this issue died out following the completion of the privatization process.

¹ The author is a post graduate student of European studies at the University in Aachen, Germany.

The economic structure of these countries until the mid-1990s was characterized by high concentration of economic power, and for this reason competition policy was mainly focused on the problem of abuse of a dominant position. This battle was that much harder as capital markets in Eastern Europe were relatively new or even non-existent, thus helping barriers for entry into a particular line of business in which one or a small number of producers had a dominant position to sustain.

The battle against cartels and other agreements that restrict competition did not yield much result in this period, as funds at disposal of the state authorities for discovering unregistered agreements were limited and legal competence incomplete.

CEE countries did not have enough experience in pursuing competition policy then, and solutions adopted by legislative authorities in this area were either too strict, making economic entities register even the most innocent agreements (Slovakia), or too loose, foreseeing very light punishments, which resulted in a very few offenses being brought to court (Hungary).

Competition Policy and Accession to the EU

Having signed the Europe Agreements between 1991 and 1996, candidate countries undertook to accept and enforce community legislation in this area; however, changes in their national competition legislation did not become visible immediately, but as late as in the period between 1996-1999.

During that period, almost all CEE countries experienced an increased inflow of foreign capital, which brought about easier access to the market and decreased concentration of economic power. Fortunately, the authorities responsible for competition policy were now much more experienced in uncovering cartels. At the same time, the majority of the CEE countries created new legal frameworks, which included necessary instruments for competition policy to be pursued efficiently (single and group exemptions, *de minimis* rule, special proceedings for crown witnesses, etc.).

The second half of the 1990s was also marked by deregulation in the majority of sectors, including so called “natural monopolies”. Although this process contributed to an increase in economic efficiency, bringing about great benefits to consumers, it turned out that market competition in these sectors required a certain degree of regulation by specialized state authorities to be able to function, in particular because of the dominant position of former monopolists. These authorities often used their powers to make decisions on fixing prices and other business conditions, which was contradictory to the practice of free competition.

Competition Policy and Accession Negotiations

In early 1999, within the accession negotiations with the first group of countries, the chapter on competition policy was opened. As a result, EU authorities paid greater attention to the control of competition policy practices, in terms of its enforcement and efficiently. The EU authorities aim to ensure strict enforcement

of *acquis communautaire* on its entire future territory, as well as undisturbed functioning of the single market, which is still a backbone of European integration. Although EU regulations in the area of competition policy, respecting the principle of subsidiarity, refer only to offenses which compromise economic flows (most frequently trade) among Member States, the Union is aware that it must not be allowed for the gray areas to appear on its territory, i.e. areas in which even national regulations (not to mention community law) are not fully enforced. This was the reason for stricter control over the work of authorities responsible for enforcement of this policy at national levels.

Moreover, the Union has discovered that the main shortcoming in the enforcement of competition policy is registered in the area of control of state subsidies, where the autonomy of decision-making authorities is even more important than in other segments of battle against restrictions of free competition. This requires special offices to be established for pursuing such a control; such offices have started operating effectively in Eastern Europe after 1999.

Exemptions from Strict Enforcement of Competition Policy for Candidate Countries

Candidate countries used the beginning of negotiations on free competition to ask for more exemptions from strict enforcement of community law in this area, in order to ease shocks to their economies resulting from transformation. This primarily concerns attempts to incorporate provisions tolerating state subsidies (mainly in the form of tax cuts and social system contributions) into the Accession Treaty, in particular in the following areas:

- Fiscal aid for small and medium-sized enterprises (partially accepted by the EU)
- Restructuring of automobile and steel industries (partially accepted by the EU)
- Fiscal aid approved by local authorities (accepted by the EU providing that allocated funds do not exceed the prescribed amount)
- Tolerance over a period of years of so called special economic zones where export-oriented companies were stimulated through tax relieves (the EU has absolutely rejected this measure – these kinds of subsidies create inequality among stimulated and unstimulated companies, resulting in their unequal position on the single market)
- Subsidies aimed at acquisition of environmental standards (partially accepted by the EU)
- Postponement of deregulation of state monopolies (rejected by the EU).

Partial tolerance on the part of the EU in the listed issues means that the EU accepts the continuance of state fiscal aid, but only throughout a contracted period of time, whereas candidate countries are obliged to produce a realistic phasing out program. Only exceptionally, i.e. in a few cases, the Union agreed to

allow state subsidies to be financed from EU funds for regional and structural support, as criteria for approving assets from the latter are much stricter.

Problems That Will Appear After Accession

Negotiations on exemptions from the prohibition of state assistance lasted until December 2002, but some issues still remained unresolved, although the Accession Treaties between acceding countries and Member States have already been signed. Some countries are taking the opportunity to subsidize their companies until the last moment, i.e. May 1, 2004, but the price will be high, i.e. in order to continue with such incentives, the assistance which has not been registered with the EU will have to pass through the process of rather strict examination on whether it is in compliance with community legislation. On the other hand, those countries which registered programs of assistance to their enterprises with the Union can count on a process of approval that is not nearly as strict.

Commissioner Monti's contentment with what was achieved in the last decade frequently turns into skepticism when it comes to the discussion whether new members will be able to keep pace with the reforms of competition policy, which are in full swing in the EU, in terms of the battle against cartels and control of mergers. Those more pessimistic stress that new member states are not mature enough to resolve cases in the area of competition policy which lie in front of them on the single market, and that these countries stand to face a surge of lawsuits initiated by the European Commission for violation of the Accession Treaty after a short period of probation.

In our country, as far as competition policy is concerned, and in spite of interesting recent legislative proposals, what still dominates is institutional lethargy. Whether this is due to someone's fear of doing injury to individual interests or to the hope that we can continue to live for some time as if it is still 1988 remains yet to be seen.

Editor	Ph.D. Mirosinka Dinkić
Prices	Kosovka Ognjenović, M.S.
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Labor Market	Jelena Momčilović
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Foreign Trade	Aleksandra Branković
Fiscal Policy	Ph.D. Mirosinka Dinkić Kristian Vukojičić
Monetary Policy	Kristian Vukojičić

Macroeconomic Review

SLOWDOWN OF THE TRANSITION

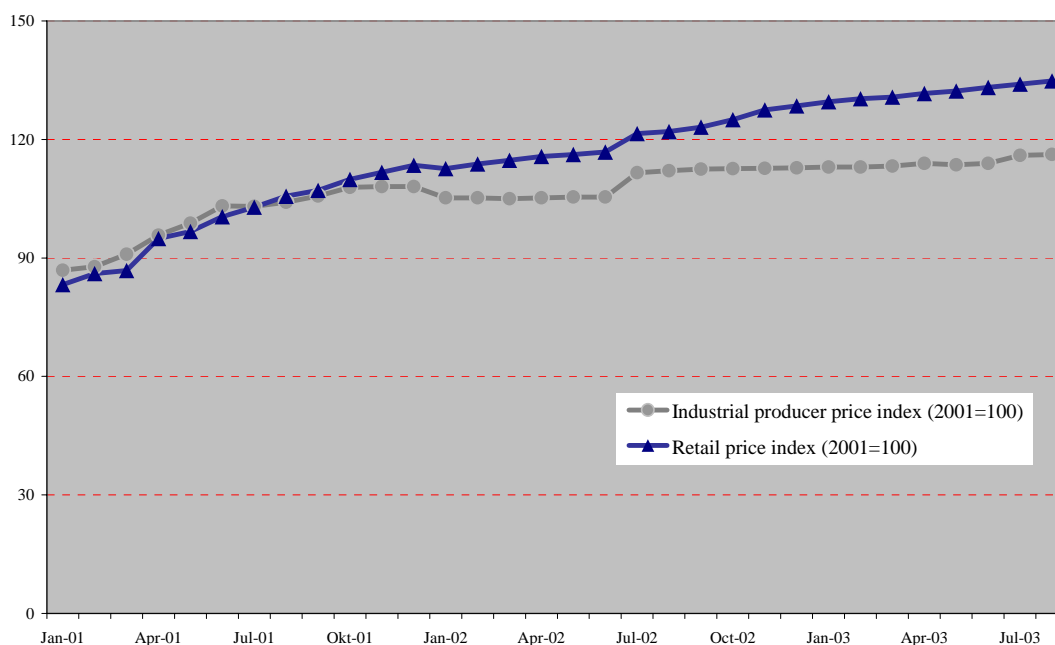
Macroeconomic stability is sustained. However, the relatively most important economic activities (according to their share in GDP) have displayed downward trends, which are slowing down considerably total economic growth, both compared to the previous year, and with regard to expectations. The labor market registered decreasing employment and rising unemployment. For several months economic activity has been developing autonomously, i.e. independently from projected macroeconomic policy. Certain positive developments in production and exports are due to capable businesspeople, who have quality management, and who are making use of macroeconomic stability and the liberalized market to operate efficiently. The absence of the Government's measures, or enforcement of inadequate measures, has set back the process of restructuring and privatization of the unprofitable socially-owned and state-owned enterprises. Hence, the social costs of the transition are growing. This implies that the existing fiscal system has started to compromise development significantly, expressing extensiveness to the detriment of effectiveness in development. It is therefore necessary to change fiscal instruments, reconsider tax rates, and extend the tax base. At the same time, the mechanisms of administration of public revenues and expenditures must be improved at all levels.

Prices

Cumulative retail price inflation in last eight months was 5%. Given the dynamics of growth in prices so far, we maintain our forecast for year-end retail prices growth rate of 8% in 2003 (G 17 Institute Economic Review, no. 40-41).

Retail prices registered an average increase of 0.6% both in July and August. Aggregate growth in prices is mainly contributed by the 4.5% increase in prices of industrial products relative to December 2002. This increase results from considerable growth in the price of tobacco products, industrial non-food products and beverages. The price of tobacco products in August was up by as much as 12.7% year-to-year, while the price of industrial food products dropped by 1.1% on average over the same period. The price of services is consistently growing faster than the price of goods, reaching a cumulative growth rate of as much as 8.7% in August relative to December, while the price of goods went up by 3.6% over the same period.

**Retail price and industrial producer price indices,
January 2001 - August 2003**



As it is highly unlikely that any significant changes will occur on the domestic market of goods and services, and since oscillations in the exchange rate had no impact on domestic inflation during the previous months, we do not expect prices to register considerable growth in the forthcoming period. With regard to the dynamics of growth in prices in the second half of 2002 and during this year, prices of agricultural products are likely to increase, due to their seasonal nature and to the forecasted fall in the value of purchases of agricultural products. The value of purchases of agricultural products was nominally down by 10.5% in the first six months of 2003, year-to-year.

As far as the prices of petroleum and petroleum products are concerned, following the Ordinance on Prices of Petroleum Products (Official Gazette of the Republic of Serbia, no. 54/2003), they shall be adjusted to variations in prices on the EU market. Therefore, any future changes in these prices depend on the development in the price of petroleum and petroleum products on the EU market, i.e. world market. There have been four adjustments in prices of petroleum and petroleum products since June, but it had no impact on total growth in prices.

Industrial producer prices in August rose by 0.2% on average month-on-month, or by 3% relative to December 2002. Growth in prices in the industry in August was equally induced by higher costs in two sections: *mining and quarrying* and *manufacturing*. Each of these two sections recorded average growth of 0.2% in August relative to July. As far as manufacturing is concerned, growth in prices for the most part resulted from a rise in the total production costs in two fields – *manufacture of coke and refined petroleum products* (2.9%) and *manufacture of paper, publishing and printing* (2.2%), whereas increase in prices in the section mining and quarrying was contributed by higher costs in the are of *mining and quarrying of energy-producing materials* (0.3%). Other areas did not register significant changes during August. Cumulative growth of industrial producer prices in the period between December 2002 and August 2003 was most pronounced in *electricity, gas and water supply* (15%, resulting from the increase in the price of electricity, in line with projections for this year), followed by *mining and quarrying* (3%) and *manufacturing* (1.6%).

Lower production costs in *agriculture* in the first six months of 2003 year-to-year resulted in the 1.7% decrease of producer prices in agriculture, mainly due to the considerable drop in *livestock breeding* (13%). Prices in the *fishery* were up by 2.2% during the same period.

In *tourism and the catering industry*, the average prices of services realized in the first seven months of this year were up by 13.45% relative to the same period the year earlier. Out of all categories of services within tourism and the catering industry, the price of tourist nights registered the highest increase, i.e. 50.3%, while the price of meals in catering establishments recorded the lowest average growth of 4.1%.

Cost-of-living inflation was halted in the last two months, given the average growth rates of 0.1% and -0.3% in July and August respectively. Cumulative growth of this indicator in the last eight months was 3.9%. Trends in the prices of food and of clothing and footwear were much slower than in the prices of other categories within the group of costs of living, displaying average growth rates of -2.5% and 1.2% respectively. The highest cumulative growth in prices from the beginning of the year was registered in the following groups: *education, culture and leisure* (14.3%), *housing* (13.1%) *tobacco and beverages* (7.7%), *hygiene and health care* (6.2%) and *transportation* (5.2%).

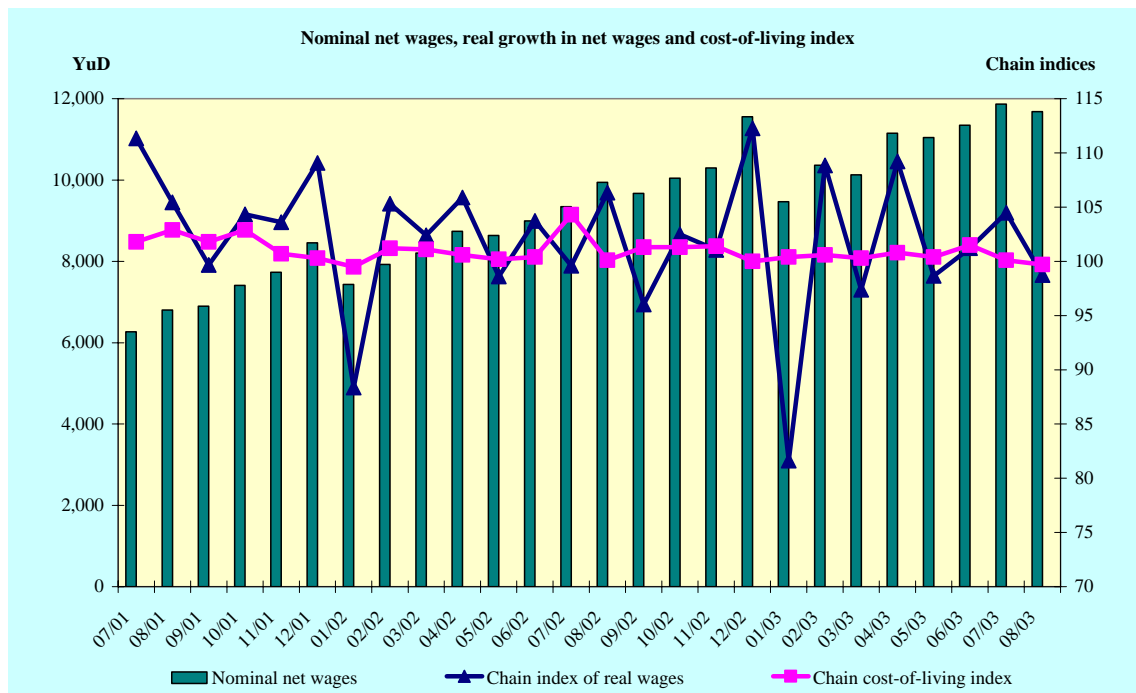
Wages and Pensions

The average net wage in July was nominally up by 4.6% month-on-month, or by 27.0% year-to-year. In the period January-July 2003 compared to the same

period last year, the average net wage increased by 27.2% nominally, or by 13.9% in real terms. However, in August the average net wage recorded a nominal decrease by 1.6%, or 1.3% in real terms. In the period January-August 2003, the average net wage rose by 25.9% nominally, or by 13.2% in real terms, compared with the same period the year earlier, implying a slowdown in both nominal and real wages.

The average net wage in Serbia in August was YuD 11,680. The gross wage in the same period was YuD 16,932, a 1.4% decrease compared to July. The average gross wage in the period January-August rose by 26.1% nominally, or by 13.4% in real terms year-to-year.

The value of the consumer basket for a four-member family in July was lower by 4.5% month-on-month, while in August relative to July it dropped further by 1.8%. The ratio of the value of the consumer basket to the nominal net wage in both months was 1.0.



In August, the net wage in the economy averaged YuD 10,984, while the average wage in the non-economic sector was YuD 13,511. This means that the average net wage in the economy in August increased by 1.2% nominally, or by 1.5% in real terms, while the average wage paid out in the non-economic sector was down by 7.1% nominally, or by 6.8% in real terms. In the period January – August the average wage in the economy went up by 11.2% and in the non-economic sector by 16.5% in real terms, year-to-year.

If we examine real growth in the net wages in specific sections of the economy in the period January-August relative to the same period the year earlier, it amounted to 6.2% in *manufacturing*, 8.1% in *mining and quarrying*, and 12.9% in *electricity, gas and water supply*. As far as manufacturing is concerned, the highest increase in wages in the period under consideration was registered in the *manufacture of tobacco products* (31.1%), while wages in the *manufacture of*

wearing apparel and fur registered the sharpest drop in real terms (23.3%). During the same period, wages in *construction* increased by 8.2% in real terms, in *transportation, storage and communication* by 15.4%, in *wholesale and retail trade* by 18.0%, *hotels and restaurants* by 9.4%, *financial mediation* by 29.3%, *sale and rent of real estate* by 25.0%, *state administration* by 21.4%, *education* 24.3%, *public health and social welfare* by 11.7% and *public utilities and personal services* by 21.6%.

The average pension paid out by the Old Age Pension and Disability Insurance Fund of the Employed in July 2003 was YuD 7,630, and encompassed the second half of the March pension and the first half of the April pension. Also in July and August the eight and ninth installment of *“the great debt”* in the amount of YuD 464 was paid out to 686,220 and 684,310 beneficiaries respectively. The pension paid out in August was nominally equal to the pension paid out the month earlier, but in real terms it was slightly higher due to a mild decrease in the cost of living index. Since pensions will be adjusted on a quarterly basis to the trends in wages and the cost of living index, the average pension increases or falls slower compared to developments in wages. The quarterly adjustment of wages caused pensions to be paid in equal amounts in a period of three months. For this reason the dynamics of comparative examination of trends in the average net wage and the average net pension paid out is comparable over a three-month basis, and it is therefore necessary to establish an adequate statistical system for following these two categories. Available data indicates that, if observed on a quarterly basis, the average pension paid out in 2003 displayed an upward trend, but this growth, for the mentioned reasons, was by over 50% lower compared to trends in the average net wage.

Such trends had a negative impact on the pensioners' standard of living. Namely, in the last three months (June-August), it took 39.6% of the average pension to purchase the items comprised in the consumers' basket per family member (in the calculation of this indicator of pensioners' standards of living, we did not take into account the amount paid out on the basis of *“the great debt”*), compared to 35.6% measured in the period March – May.

Labor Market

The labor market displayed negative trends in the period January-July – employment decreased, while unemployment rose. The unemployment rate in July was 32.4%, a considerable year-to-year increase (in July 2002 it was 28.9%).

During the period under consideration, total employment decreased by some 2.6% year-to-year, whereby the number of the employed in the socially-owned sector dropped by 6.5%; employment in private shops increased by 11.0% (including employers) and in small-sized enterprises by 1.1%

In July 2003, 1,384,000 persons were employed in the socially-owned sector, 418,400 persons worked in small private shops, while 223,000 persons worked in small-sized enterprises.

Employment in industry is permanently decreasing. In the period January-July the employment in *manufacturing* dropped by 10.6% year-to-year, in *electricity, gas and water supply* by 0.7% and in *mining and quarrying* by 5.8%. Over the same period, the employment in *construction* decreased by 6.5% and in *transportation, storage and communications* by 5.2%.

Unemployed persons registered at the Employment Office for longer than two years constitute 54.7% of total unemployment. What is more, 20.6% of those unemployed for more than two years do not have any working experience. In July 2003, this category of the unemployed increased by 10.8% compared to the same period the year earlier.

The average number of unemployment benefits recipients in the period January-June rose by 50.7% year-to-year. In June, it totaled 90,433 persons, an increase of 29.7% relative to June 2002. However, the number of unemployment benefits recipients has been showing a mild declining trend since April. Persons who lost their jobs as redundant workers (63.8%) dominate in the structure of unemployment benefits recipients, while those who lost their jobs on the basis of bankruptcy and liquidation take considerably lower share (29.9%).

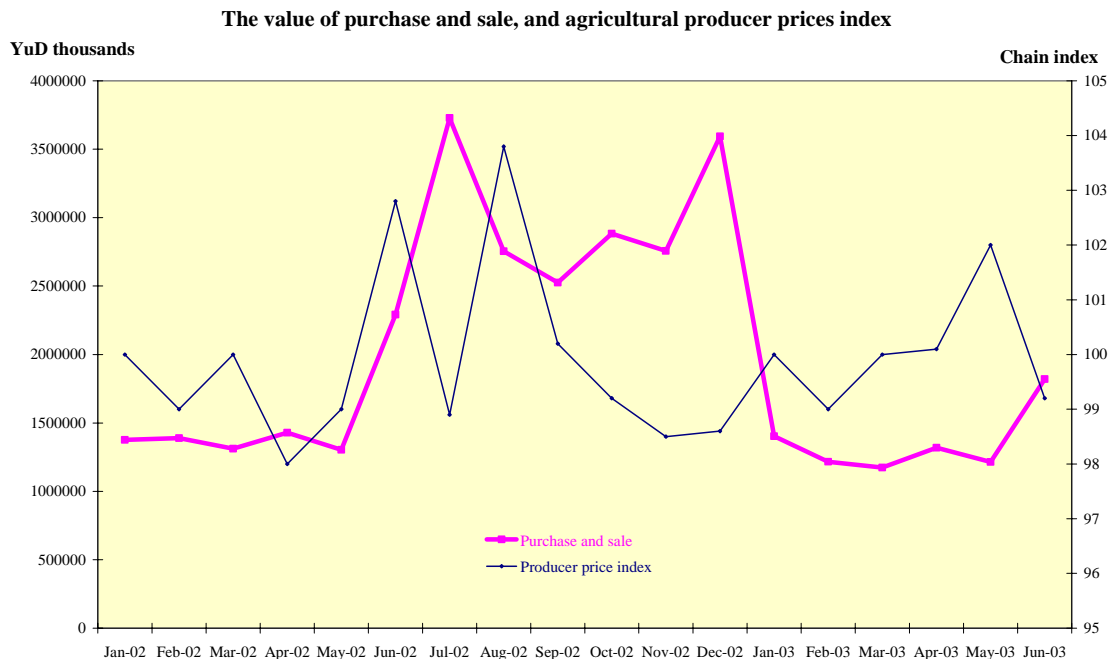
The demand for labor in the period January-June was up by 2.1% year-to-year, while in July only it dropped by 2.3% relative the same period last year.

The number of new jobs in the period January-June 2002 was up by 6.4% relative to the same period the year earlier, but in July year-to-year it increased by as much as 20.6%. In the structure of persons who initiated employment in July 2003, the highest growth refers to fluctuation (35.1%), followed by the formerly unemployed persons who were registered at the Employment Office (11.2%), while employment of trainees and junior staff dropped by 9.5%. The extent of the demand for labor fulfilled during this period was 85%, while fluctuation accounted for 43.3% of total new jobs, displaying a considerable increase relative to the same period last year, when fluctuation took 36.2% of total new jobs.

Production and Services

Industry and *agriculture* registered a year-to-year downward trend in the period January-August. The same applies to the *tourism and catering industry* and *passenger transportation* in the period January-June. At the same time, *construction, trade* and *freight transport* recorded positive trends. If such developments continue in the coming months, until the end of 2003, the GDP will record considerably slower growth, or even stagnation relative to the previous year. This would compromise further progress of reforms. In a situation when a relatively large portion of the citizens of Serbia is earning barely enough for living expenses and for providing for their families, and with the existing structure of fiscal instruments, the tax base and valid tax rates, it is really difficult to pursue a distribution that favors investments. Hence, the question arises as to how to resolve the most important problems of our transition: open and hidden unemployment, increase in development efficiency and consequent exports competitiveness, and servicing of domestic and foreign debts.

Industrial production in Serbia in August was down by 9.3% relative to last year's average, or by 5.7% compared to the same month the previous year. At the level of the Republic, industrial production decreased by 3.8% in the first eight months year-to-year – by 5.0% in Central Serbia and by 1.2% in Vojvodina.



With regard to industrial sections, *mining and quarrying* increased by 1.4%, *electricity, water and gas supply* was down by 3.7%, while *manufacturing* registered a sharp drop by 6.6%. In the period January-August compared to the same period the previous year, the sharpest drop was registered in *manufacturing* (- 5.1%), followed by *mining and quarrying* (-3.7%), while 1.3% increase in *electricity, water and gas supply* caused the total decrease in the industry to be lower.

Industrial production in August decreased year-to-year also with regard to the destination of consumption. The production of capital goods was down by 34.0%, the production of intermediate goods by 3.7% and the production of consumer goods by 4.6%. In the period January – August compared to the same period the previous year, the production of capital goods plummeted by 23.7%, while the production of consumer goods and intermediate goods dropped by 3.7% and 2.0% respectively.

Within *mining and quarrying*, in August 2003 year-to-year, *mining of coal* rose considerably (by 13.0%), while *mining of metal ores* dropped sharply by 29.7%. In the first eight months of 2003 compared to the same period the previous year, all fields of this section registered a decrease in output (in the *manufacture of metal ores* by as much as 27.6%), except for *mining of coal*, which was up by 1.1%.

As far as *manufacturing* is concerned, only four fields out of twenty three registered an increase in production in August year-to-year: *the manufacture of leather and leather products*, *footwear* (by 9.6%), *the manufacture of basic*

metals (by 5.8%), the manufacture of chemicals and chemical products (by 4.6%) and the manufacture of transport equipment (by 4.1%). At the same time, the manufacture of radio, television and communication equipment was down by 55.9%, and the manufacture of wearing apparel and fur by 48.8%. With regard to the period January-August, compared to the same period the previous year, five fields registered an increase: the manufacture of chemicals and chemical products (13.1%), the manufacture of coke and refined petroleum products (10.8%), the manufacture of basic metals (6.5%), the manufacture of rubber and plastic products (0.8%), and publishing, printing and reproduction (0.5%). During the period under consideration, the majority of fields of manufacturing registered a fall in output that exceed 10%, while only five fields decreased by less than 10%. The manufacture of office machinery and components was in stagnation. The manufacture of wearing apparel and fur decreased by 44.8%, the manufacture of precision and optical instruments by 32.8%, the manufacture of products of wood and cork other than furniture by 31.1%, the manufacture of textile yarns and fabrics by 27.9%, the manufacture of radio, television and communication equipment by 27.7%, the manufacture of leather and leather products, footwear by 18.6%, the manufacture of pulp, paper and paper processing by 17.6%, the manufacture of transport equipment by 13.7%, the manufacture of other mineral products by 13.0%, the manufacture of machinery and equipment other than electrical by 13.0%, etc.

According to the data on the value of the purchase and sale of agricultural products, agricultural production is estimated to have fallen by about 11.0% in the first six months compared to the same period the previous year. Agricultural producer prices were down by 1.7% during the same period. Agricultural production is estimated to have decreased by 9.0% in real terms in the period January-June 2003 year-to-year. The decrease in agricultural production was due to bad weather conditions, for which the yield of cereals and fruits was considerably reduced. At the same time, the production of livestock and poultry also decreased, resulting from a permanent drop in redemption price of these products. Redemption prices of livestock products during the first six months of 2003 decreased by 12.6% year-to-year.

The value of construction works realized in the first six months increased by 31.7% nominally, or by 15% in real terms, year-to-year. Gross labor costs take a relatively large share in the total value of realized construction works, but this share was lower compared to the previous year (from 69.5% to 59.2%) due to lower employment; while gross labor costs grew by 12.1% nominally. However, despite reduced registered employment in construction, effective hours of work increased by 7.8%. This also indicates that the volume of activities in construction increased in real terms during the first half of the year. The manufacture of non-metal minerals, most of which are used in construction, decreased during the period under consideration, but at the same time, stocks of finished products in this area increased in real terms (by 13.4%), as well as imports (by 27% in YuD, or by 20.5% calculated in EUR).

The volume of freight transport measured in ton kilometers rose by over 15%, while passenger transport decreased. Activities in transport in general decreased by some 2.5% in the first six months of 2003 year-to-year.

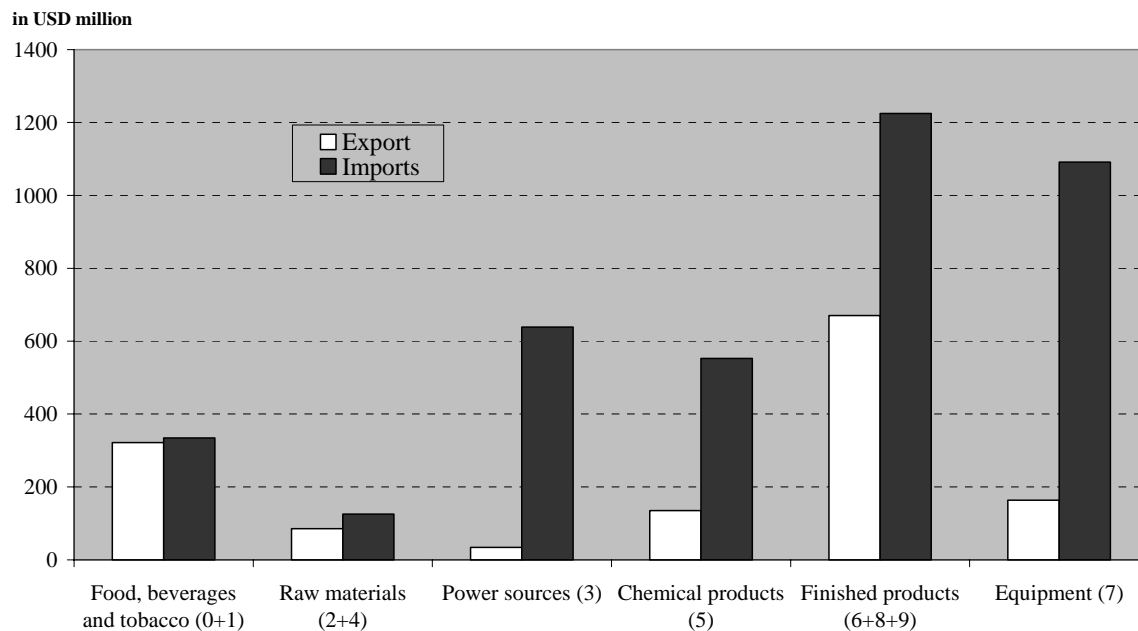
Retail trade turnover in the period January – July was up by 15.2% in real terms year-to-year; in July, retail trade turnover registered a 4.5% month-on-month increase. Real turnover in the catering industry was down by nearly 10%. The turnover in tourism, measured in tourist nights, was lower by 2.8%. What is important for this activity is that turnover increased in most spas and mountain resorts in Serbia, but decreased in towns. Therefore, measures should be taken to reconstruct and repair hotels in towns and prepare them to host tourists, including conditions for conferences and other gatherings. At the same time it will be necessary to improve tourist offers in certain spas and mountain resorts, in particular in central and southern Serbia.

Foreign Trade

According to preliminary data, commodity exports from Serbia in July were valued at US\$ 220 million, a year-to-year increase by 9% nominally; commodity imports were valued at US\$ 536 million, which is nominally up by 7% compared to the same month the previous year.

From the beginning of the year, commodity exports have been growing at a slower pace than commodity imports, and for this reason the trade deficit has continued to widen. The trade deficit reached US\$ 2.5 million already during the first seven months of 2003, a 35% year-to-year increase (measured in nominal US\$).

Structure of Serbian trade (SITC sections), Jan-July 2003.



Such an intensive growth of foreign trade both on the exports and imports sides was due to real depreciation of the US\$ relative to the EUR, and hence relative

to the YuD. The picture is completely different when observed in real YuD (retail price index used as a deflator) or in nominal EUR (calculation based on medium cross rate of exchange of EUR and US\$). It might be said that cumulative values of both commodity exports and imports, observed in real YuD, have been in stagnation during this year, while, expressed in nominal EUR, they registered an increase relative to corresponding values in the same period previous year, but that increase is considerably milder than when expressed in nominal US\$.

Although without thorough analysis it is not possible to say precisely what are the actual growth rates of our foreign trade, it seems that the rise in commodity imports is less of a problem (since the imports value expressed in YuD and EUR does not register a worrying increase year-to-year), but the problem lies in insufficient growth in commodity exports.,

With regard to the Standard International Trade Classification, exports are dominated by technologically-unsophisticated semi-finished products, as well as labor-intensive products comprised in sections *food and live animals*, *manufactured goods classified by material* and *miscellaneous manufactured articles*. These three sections together constitute two-thirds of our total commodity exports. Such an export structure indicates that competitiveness on a modern market cannot be based on the export of resource-intensive and labor-intensive products, and this is one of the explanations for the unsatisfactory export performances of our economy. To be fair, intensive export growth can be achieved even with such an export structure, providing that it is based on high productivity and efficiency in production, production and market differentiation and good marketing. However, this is not the case with the majority of our enterprises. The concept of competition in our country is still being associated with low labor costs; yet, given that real wages increased considerably over the past three years (whereby a mild growth in productivity was for the most part due to the reduction in the number of workers), it may be assumed that the Serbian cost competitiveness has been lost, or at least reduced, compared to some neighboring countries.

The import side is dominated by *machinery and transportation equipment*, followed by *manufactured goods classified by materials* (in particular textiles and textile products) and *power sources* (petroleum and petroleum products). As far as the imports of equipment are concerned, the largest share is taken by road vehicles, with the export value exceeding US\$ 285 million in the first seven months of 2003.

Fiscal Policy

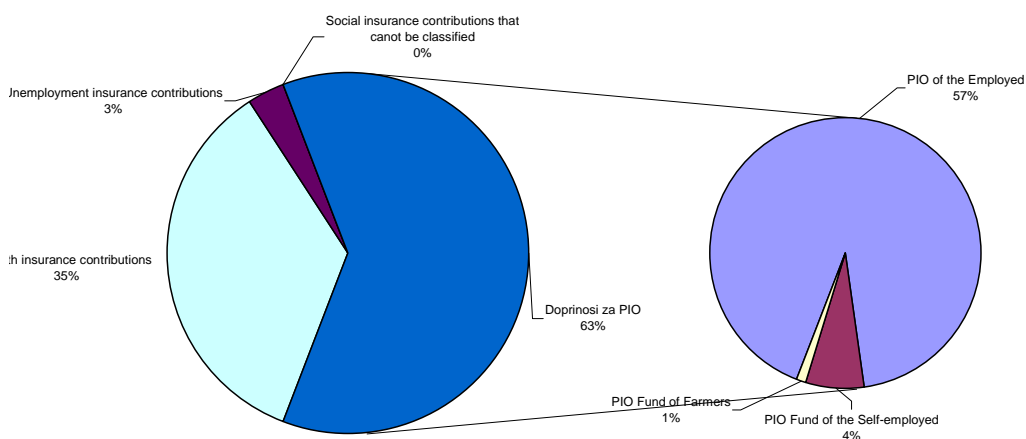
Gross public revenues dynamics in the first eight months of 2003 relative to the same period last year implies that the process of fiscal decentralization should be accelerated, as public revenues collection at the local levels has proven to be the most efficient.

According to the data released by the Treasury of the Republic of Serbia, gross total public revenues increased nominally by 5.9% in the period January-August year-to-year. Total current public revenues were up by 3.8%, while revenues

from the sale of non-financial assets (state-owned real estate) increased 39 times and revenues on the basis of borrowing and sale of financial assets, 2.4 times.

With regard to levels of governance, the most intensive growth of gross public revenues was registered in municipalities (2.9 times, year-to-year), then at the level of groups of municipalities (49.7%) and at the level of the Republic (13.2%). Revenues to the budget of the State Union during the period under consideration were lower by 67.8%, while public revenues at the level of the Autonomous Province were down by 17.7%.

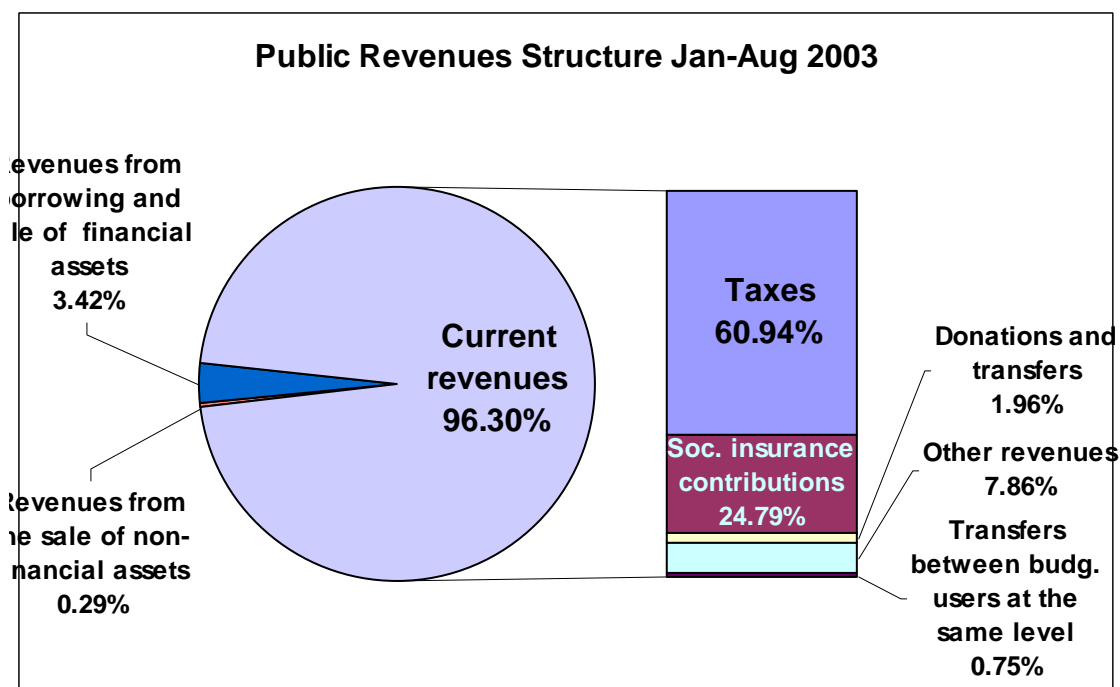
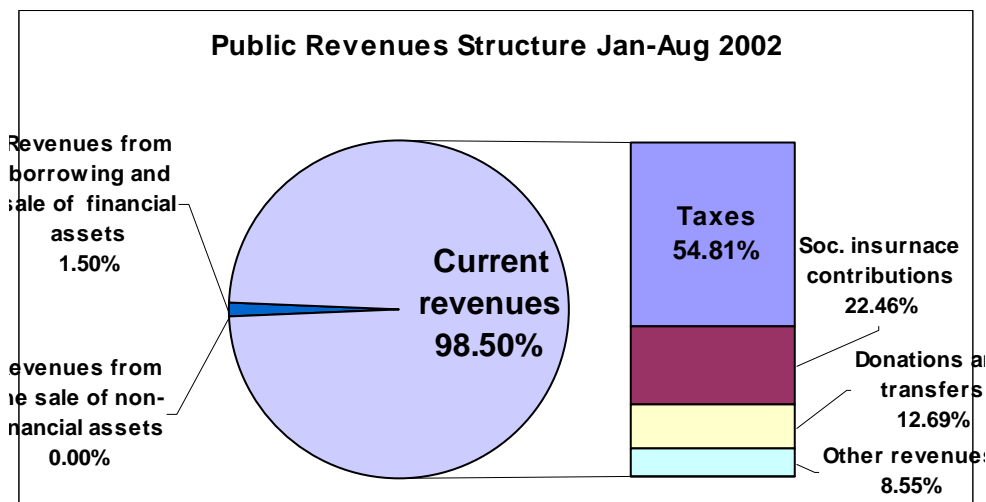
Struktura bruto prihoda organizacija socijalnog osiguranja (januar-avgust 2003. god.)



The structure of current public revenues, however, displayed considerable changes compared to the first eight months of the previous year. The share of revenues from taxes in the total gross revenues increased from 54.8% in the period January-August 2002 to 61.1% in January-August 2003; the share of contributions for social insurance increased from 22.5% to 24.9%, and of revenues from borrowing and sale of financial assets from 1.5% to 3.4%. At the same time, the share of donations and transfers (to other levels of governance) decreased from 12.7% to 2.0%, and of other revenues from 8.6% to 7.9%. These changes are due to trends in the collection of specific sorts of public revenues. Thus, revenues from taxes increased by 18.0%, from social insurance contributions by 17.2%, while revenues from donations and transfers from other levels of government decreased by 83.6% and other revenues (revenues from property, taxes, rents, fines, revenues from divested and sold assets, voluntary transfers from physical and legal persons, and other mixed and indeterminate revenues on behalf of certain levels of government and organizations of social insurance) decreased by 2.4%.

In the structure of social insurance contributions in the period January-August 2003, a year-to-year increase was registered in the share of contributions for old

age pension and disability insurance (from 60.6% to 61.4%), revenues from health insurance contributions slightly dropped (from 36.0% to 35.2%), while revenues from contributions on the basis of unemployment insurance sustained the same level (3.4%); the share of unclassified social insurance contributions increased slightly (from 0.04% to 0.05%).



Monetary Policy

Money supply registered a considerable month-on-month increase by YuD 9 billion in August. However, the level of money supply of YuD 114 billion is not worrying, especially when it is taken into account that this growth was mostly due to the increase of deposits (89%). The amount of other short-term deposits rose significantly in July and August to about YuD 25 billion; during the first six months of this year, this indicator ranged between YuD 14.5 billion in January, YuD 13.5 billion in February to YuD 17.1 billion in June. Owing to this increase, the monetary aggregate M2 at the end of August reached YuD 138.5 billion.

The money market registers no significant changes. The average weighted active interest rate in last five months fluctuates about 1.25% at a monthly level. The interest rate on commercial and treasury bills and certificates of deposit on the Belgrade Stock Exchange fluctuated about 2% at a monthly level. The interest rate on treasury bills of the NBS varies about 11%, indicating a one-digit inflation at the end of the year.

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Serbia w/o Kosovo and Metohija: Basic Economic Indicators

	$\frac{\theta \text{ 2002}}{\theta \text{ 2001}}$	VII 2003	VIII 2003	$\frac{\text{VIII}2003}{\text{VII}2003}$	$\frac{\text{VIII}2003}{\text{VIII}2002}$	$\frac{\text{I-VIII}2003}{\text{I-VIII}2002}$
GDP growth rate¹	4.0%	...	...	...	...	...
Industrial production - total	1.7%	...	...	-1.3%	-5.7%	-3.8%
Central Serbia	1.6%	...	...	-4.7%	-7.5%	-5.0%
Vojvodina	2.1%	...	...	5.8%	-2.0%	-1.2%
Average nominal net wage, YuD²	51.8%	11,865	11,680	-1.6%	17.5%	25.9%
Nominal gross wage, YuD	...	17,167	16,932	-1.4%	18.3%	26.1%
Real growth in average net wage, in %³	30.2%	...	...	-1.3%	8.8%	13.2%
Ratio consumer basket / average net wage	-31.1%	1.0	...	-0.3%	-13.5%	-18.3%
Unemployment rate, registered⁴	8.1%	32.4%	...	1.1%	12.0%	13.9%
Current account, in USD million⁵	227.8%	-184	...	37.3%	84.0%	36.2%
Trade balance, in USD million⁶	39.3%	-317	...	-10.9%	6.5%	35.1%
Exports, USD million	20.6%	220	...	5.5%	8.8%	27.2%
Imports, USD million	31.8%	536	...	-2.3%	7.4%	32.2%
Money supply (M₁), YuD billion. (end of period)	110.8%	105	114	8.6%	43.9%	72.7%
Cash	122.6%	38	39	2.0%	73.5%	97.0%
Deposit	104.6%	67	75	11.9%	47.7%	60.1%
Real money supply, EUR million	107.5%	1612	1749	8.5%	33.5%	55.6%
NBS for. curr. reserves, USD mil (end of period)	95.0%	2540	2695	6.1%	28.5%	45.6%
Discount rate - annual level	-77.0%	9.0%	9.0%	0.0%	-5.3%	-22.8%
Market interest rate - monthly level	-48.5%	1.2%	1.3%	1.6%	-26.0%	-34.5%
Retail prices	19.5%	...	...	0.6%	10.5%	13.4%
Costs of living	16.6%	...	...	-0.3%	8.0%	11.2%
Industrial producer prices	8.8%	...	...	0.2%	3.6%	4.9%
Medium exchange rate (YuD/EUR) - average	2.1%	65.12	65.19	0.1%	7.0%	6.1%

¹ Estimate

² By the gross wage methodology applied as of June 1, 2001

³ Deflator is cost-of-living index

⁴ These figures include the employed in the socially-owned sector, private sector and small enterprises

⁵ The data refer to May

⁶ The data refer to July

Source: SZS, RZS, NBS, RZTR